Global Strategy Q3 2018

The economic expansion remains robust but is currently beset by an increase in uncertainty. While the Fed continues to implement gradual rate hikes, the ECB is likely to leave interest rates unchanged through the summer of 2019. Yields on German Bunds should only rise slowly, safe haven investments are not overly popular in an environment like the current one. Continued strong fundamental data are lending support to stock markets, as well as IG hybrid and HY corporate bonds.

Investment Strategy Q3 2018:

Govt. bond yields		Sept. 2018
Germany (10Y)		0.60
USA (10Y)		3.20

Currencies		Sept. 2018
EURUSD		1.14
CHF		1.16

Equity Performances		Sept. 2018
Global	➚	0%/ +5%
Europe	➚	0%/ +5%
USA	➚	0%/ +5%

Source: Erste Group Research

Prices as of
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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

The outlook for an acceleration of US economic growth this year is good. Massive fiscal stimulus has left its tracks, particularly consumer spending exhibited strong growth momentum in Q2. So far the trade dispute has not done any noticeable damage to the performance of the US economy. The volume of trade that is affected remains hitherto small and it is too early to quantify the indirect impact of the increase in uncertainty triggered by the trade dispute. The inflation rate should moderately increase in coming months, but risks remain skewed to the upside. Growth momentum in the euro zone has weakened somewhat and we expect GDP growth for the year as a whole to marginally decrease compared to the previous year. Recent weakness in the euro should lend support to exports, but the trade dispute could eventually weigh on foreign trade. Domestic demand and investment spending should at the same time remain strong in H2. Headline inflation in the euro zone is expected to slightly increase to an average of 1.6% this year.

Bonds

The ECB has committed itself to a monetary policy course until well into 2019. Net purchases of securities by the central bank are to be finally discontinued at the end of the year, while reinvestment of proceeds from maturing bonds in its portfolio will be continued for a long time thereafter. The future course of interest rates was the most important aspect of the ECB's guidance. Interest rates are to remain at current levels until after the summer of 2019. In view of this, as well as due to political tensions, bond yields should only rise slowly. By contrast, the Fed continues to regard further gradual rate hikes as necessary. Thus we expect two more rate hikes in the US until the end of the year (in September and December). US trade policies have triggered uncertainty in financial markets. Hence the yield on the 10-year treasury note currently trades close to 2.9%. We expect yields to moderately increase until the end of the year.

Currencies

A lack of speculation on imminent rate hikes in the euro zone should continue to put pressure on the euro against the US dollar. In response to a continuing global economic expansion, we believe the Swiss franc will gradually weaken against the euro, provided political tensions do not escalate. We expect gold to move sideways.

Stocks

In view of greater uncertainty, stock market indexes of developed countries should continue to outperform those of emerging markets. US equities in turn should exhibit relative strength compared to European stock markets. All in all we expect global stock indexes to advance amid elevated volatility and post gains in a range from 0% to +5%

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Investment Strategy Q3 2018

Yields		current	Estimates Q3 18	Q4 18	Q1 19	Q2 19
10y. Govt. bonds	**Germany**	0.31	**0.60**	0.80	0.90	1.00
	Austria	0.57	**0.80**	1.00	1.10	1.20
	US	2.83	**3.20**	3.30	3.50	3.50
	CEE					
	Czech Republic	2.16	**1.85**	2.00	2.08	2.15
	Hungary	3.74	**3.31**	3.36	3.40	3.49
	Poland	3.27	**3.20**	3.40	3.50	3.50
	Romania	5.15	**5.10**	5.40	5.40	5.60

Source: Erste Group Research estimates

Currencies		current	Estimates Q3 18	Q4 18	Q1 19	Q2 19
Global	**EURUSD**	1.16	**1.14**	1.13	1.15	1.16
	CHF	1.15	**1.16**	1.17	1.18	1.19
	Gold (USD)	1,256	**1,280**	1,280	1,280	1,280
CEE	**CZK**	26.12	**25.1**	25.0	24.8	24.7
	HUF	327.74	**326**	325	325	325
	PLN	4.40	**4.24**	4.21	4.19	4.19
	RON	4.66	**4.70**	4.73	4.74	4.75

Source: Erste Group Research estimates

Equities		Estimate Q3 2018	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

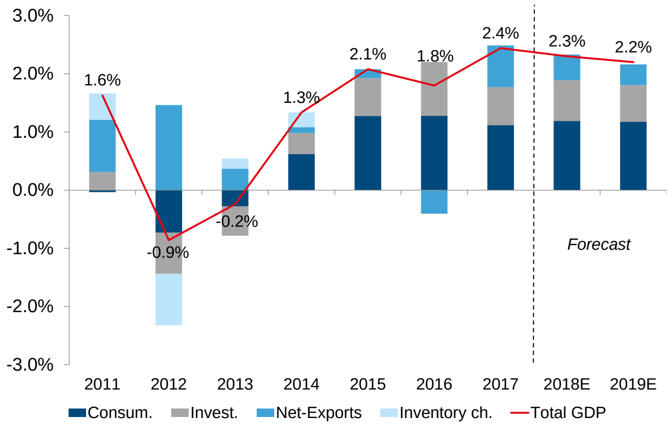
Euro Zone Economic Outlook

Trade dispute weighs on outlook

Foreign trade momentum wanes in Q1 2018

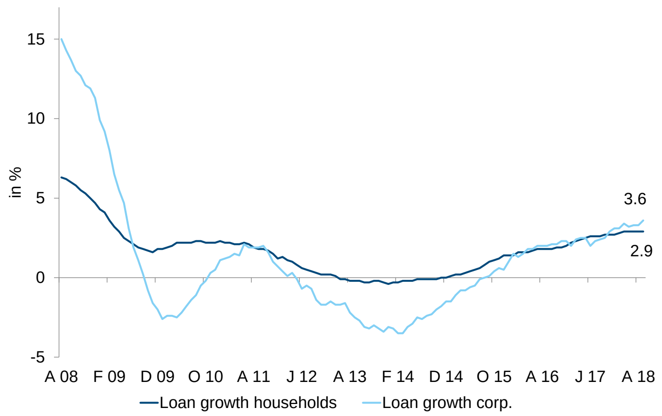
Economic growth in the euro zone weakened somewhat in Q1 2018 as the growth momentum of foreign trade waned significantly after advancing strongly in 2017. By contrast, both consumer spending (+1.6% y/y) and investment spending (+3.6% y/y) exhibited a moderate increase in growth momentum in the first quarter. Residential construction as well as machinery and equipment provided the largest contributions to investment spending. Consumer spending benefited mainly from strong growth in Spain and Germany; unemployment rates in both countries are steadily declining. On the other hand, in France and Italy sluggishness in labor markets is mirrored by below-average growth in consumer spending. However, due to the targeted reform measures implemented by the French government we expect momentum in the French labor market to pick up in the medium term and boost consumer spending accordingly. We remain skeptical with respect to Italy, as leading lights of the new government are evidently not focused on improving the efficiency of product or labor markets

GDP forecast 2018-2019
Foreign trade weighs on growth in 2018



Source: Eurostat, Erste Group Research

Euro zone credit growth, households and corporations
Steady uptrend supports domestic demand growth



Source: Bloomberg, Erste Group Research

Trade dispute weighs on outlook for second half of 2018

We expect GDP growth in the euro zone to stabilize in the second half in range of around +0.4% to +0.5% q/q. The recent weakness in the euro should support export growth, even though the trade dispute is certain to weigh on foreign trade. A sustained steady uptrend in credit growth in the household and corporate sectors should support growth in domestic demand and investment spending in H2. **We are forecasting GDP growth of +2.3% for the euro zone in 2018.**

Headline inflation should rise slightly in 2018 (to around +1.6%)

We expect consumer price inflation in rise moderately in 2018 to an average of +1.6%. Considerable uncertainty remains regarding the extent to which the ongoing recovery will be reflected in higher core inflation rates. The trend in core inflation was at times below expectations, inter alia due to the regional fragmentation of the labor market.

US Economic Outlook

US economic growth accelerates

Q2 data indicate significant acceleration in US economic growth

Monthly economic indicators point to a significant acceleration in US GDP growth in the second quarter after a rather muted first quarter. The main driver was a strong spurt in the growth of consumer spending. This confirms that prospects for the US economy remain strong, and supports our expectation that growth is set to accelerate for the year as a whole.

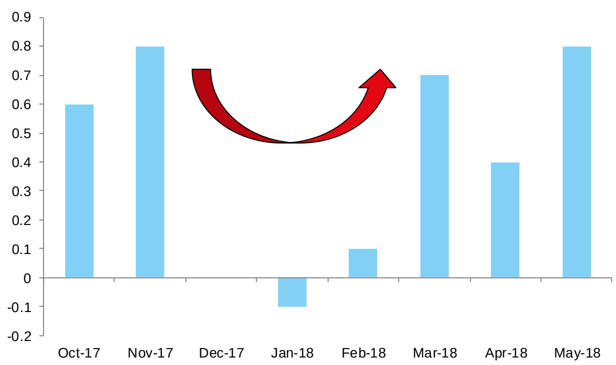
Trade disputes have so far no noticeable economic impact

Apart from recent economic data, the administration's massive fiscal stimulus also suggests continued economic strength. After all, a tax cut has been implemented in December, and a significant increase in public spending was passed in February to boot. The recent trade disputes with virtually all important US trading partners have so far failed to dent the performance of the US economy noticeably. So far the affected volume of trade is relatively small and as the tariffs have taken effect only recently and partially, it is simply too early to gauge their impact. Due to the complexity of global supply chains it is difficult to estimate the impact in advance. Another factor that makes it hard to arrive at a reliable estimate is the fact that although the US economy is overall far less dependent on exports than e.g. the euro zone, China or Japan, US exports are currently affected by additional tariffs to roughly the same extent as US imports. Should there be no further expansion of the affected volume of trade, we would consider it unlikely that there will be a noteworthy direct macroeconomic impact. However, indirect effects on the economy due to the uncertainty triggered by the trade dispute become increasingly likely the longer the conflict lasts.

No evidence of a significant increase in inflationary pressure as of yet

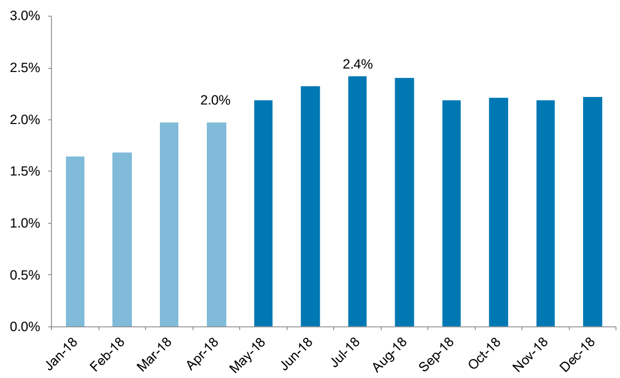
In March a significant decline in the prices of cell phone services recorded in the previous year was no longer included in the calculation of price inflation, which led to a surge in PCE, the price index most important to the Federal Reserve. We believe inflation rates will continue to rise moderately in coming months. However, this will mainly be attributable to base effects and energy prices and will therefore not point to a persistent strengthening of inflationary pressures. Nevertheless, there continues to be a risk that inflation will accelerate above and beyond these temporary effects. The unemployment rate seems set to fall further and strong aggregate demand (fueled by fiscal stimulus) in conjunction with high capacity utilization, could lead to the pace of inflation picking up further.

Upturn in retail sales
Retail sales, m/m in %



Source: Bloomberg, Erste Group Research

Inflation rate should increase only temporarily
Inflation (PCE), y/y in %



Source: Bureau of Labor Statistics, Erste Group Research

CEE Economic Outlook

While economic growth slowed in the Euro Area in 1Q18, we saw several upside surprises in the CEE region in GDP growth numbers. The largest positive surprise came from Poland (5.1%), where we revised our growth forecast to match that of last year (4.6%). In Hungary, we also revised our growth outlook for 2018 to the upside to match last year's 4.0%. Deceleration in the Czech Republic (from 4.6% to 3.6% this year) and especially in Romania (from 6.9% to 4.1%) seems unavoidable, however. Growth in CEE is still primarily driven by consumption and investments. In Romania, growth of household consumption (previously driven by fiscal stimuli) has decelerated, but it remains the highest in the region. Hungary reported the fastest investment growth (17.1% y/y in 1Q18), but it was exclusively driven by the public sector, while private investments remained almost flat.

Higher food prices, together with the brisk recent rise of oil prices (even stronger when compared to the falling base from the previous year), resulted in a fairly strong uptick in headline inflation across the region. In Hungary and especially Romania, inflation rates in May went to levels that might raise some eyebrows. In Hungary, inflation accelerated to 2.8% in May, from about 2.0% in 1Q18, and thus stayed only one notch below the central bank target (3%). Inflation in Romania went to 5.4%, well above the upper limit of the target. While core inflation does not point to any strong inflationary pressure at the moment in CEE, inflation returned above the central bank's 2% target in May in the Czech Republic and we expect it to stay above this level for the remainder of this year, as steep wage growth may force producers to ask for higher prices at some point in time.

Although external demand seems solid, its best momentum is probably over for CEE. This is especially visible when looking at German manufacturing PMIs, which fell substantially, to 56.9 in May, from 63.3 in December 2017. Volume-based export figures show a visible deceleration of exports in 1Q18, while import dynamics outperformed the growth of exports in almost all CEE countries. Import dynamics are expected to stay strong, given the expected growth in domestic demand in CEE. Surpluses, or at least a roughly balanced situation in current accounts, helped CEE currencies in the last few years, but this situation may slowly be waning, weakening the helping hand extended to local currencies.

BRIC Economic Outlook

China

Yuan vs. USD

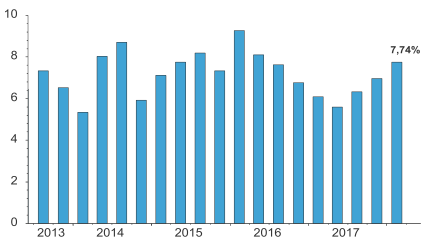
Source: Bloomberg, Erste Group Research

Trade dispute with the US weighs on the economic outlook. After China responded to punitive tariffs imposed by the US by levying tariffs on US imports in return, the situation escalated further at the end of June, as president Trump threatened to impose additional punitive tariffs on imports totaling USD 200bn. China's exposure in the trade dispute is particularly pronounced, due to its significant trade surplus with the US. The recent escalation raised doubts about the growth prospects of the Chinese economy and the yuan slumped markedly against the USD in a very brief period of time. Should the recent weakness in the yuan persist, China's foreign exchange reserves could come under pressure similar to 2014 and 2015, which in turn could increase the nervousness of investors even further.

We expect that China's political leadership will make use of all means at its disposal in order to ensure that China's economy will achieve the GDP growth target of 6.5% to 7.0% in both 2018 and 2019 despite growing uncertainty. The People's Bank of China has already reacted to the uncertainty and announced that it stands ready to support the economy with a comprehensive range of measures. In addition to this, China could apply fiscal stimulus in order to prevent a potential slowdown in economic growth. However, China must ensure that loose monetary and fiscal policy measures do not come at the expense of long-term financial stability. In 2017 the authorities succeeded in dampening credit growth somewhat.

India

India: GDP growth in %, y/y



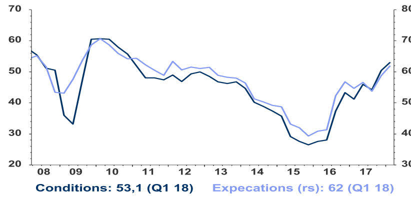
Source: Datastream

India's GDP grew by 7.7% year-on-year last quarter. This was a further increase in the growth rate compared to the previous quarter (+7%). The IMF expects GDP growth of 7.2% in 2018, followed by +7.7% in 2019.

The manufacturing purchasing managers index for May stood at 51.2 points. The manufacturing sector continues to expand, albeit at a slower pace than in the previous month. Both production volumes and new orders have increased. Rising consumer goods production continues to outpace the decline in capital goods production. Negative effects were seen in the form of rising input costs. Indian companies reported the strongest growth in export orders since February. The services purchasing managers index recently posted a reading of 49.6 points, signaling a moderate contraction. New orders stagnated in this sector.

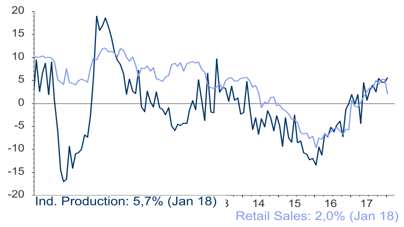
In May, the inflation rate has reached the highest level in four months. It currently stands at 4.9% y/y, which is significantly above the 4% target of the Reserve Bank of India. Consequently the central bank has hiked its repo rate to 6.25% in Q2. As inflationary pressures continue to persist, further rate hikes appear likely this year.

Brazil: Industrial Entrepreneur Confidence Index



Source: Datastream, Erste Group Research

Brazil: Industrial production (y/y) and retail sales (y/y)



Source: Datastream, Erste Group Research

Brazil

Brazil

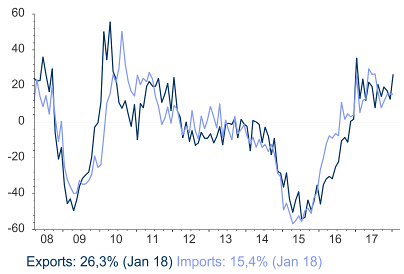
The prospects for economic growth in Brazil have deteriorated last quarter. Recent consensus estimates are calling for GDP growth of +2% (y/y) in 2018. In the coming year output growth is expected to accelerate to +2.6%. Purchasing managers indexes have recently decreased somewhat. This applies both to the assessment of current conditions as well as future business expectations.

The unemployment rate stands at 12%. The consensus expects a decline to 11.3% in the coming year. Consumer spending continues to play an important part in the current economic recovery. In 2018 a growth rate of +2.5% (y/y) is expected. The budget deficit continues to be very high at -7.4% of GDP. In the coming year it is seen to improve to -6.5% of GDP.

Industrial production remains in an uptrend. The expected growth rate for this year is +3.8% y/y, followed by +3.0% in 2019. Estimates for the expected pace of inflation this year have decreased. It is currently estimated that consumer prices will rise by +3.5% (y/y).

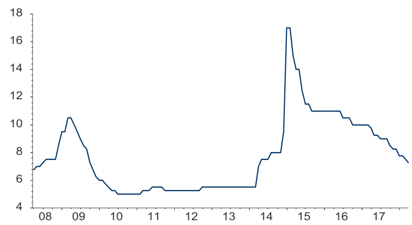
The central bank of Brazil has left the Selic rate unchanged at 6.5%. The consensus doesn't expect a rate cut this year. Both government bonds and the currency came under selling pressure last quarter. The yield on 10-year bonds stood at approximately 11.7%.

Russia: exports are currently rising faster than imports



Source: Datastream, Erste Group Research

Russia: main refinancing rate



Source: Datastream, Erste Group Research

Russia

According to consensus estimates Russia's economy is likely to grow by +1.8% (y/y) in 2018. GDP growth is expected to come in at the same level over the coming two years.

The growth rate of consumer spending is expected to reach +3.2% this year. The pace of consumer price inflation is likely to decelerate further. Currently the inflation rate is expected to fall to +2.9% in 2018, followed by an increase to +4.0% in 2019.

Consensus estimates call for industrial production to grow by +1.9% this year. The same growth rate is expected to be achieved next year. Exports are currently growing especially fast, with an increase of +31.4% (y/y) recorded last quarter.

The year-on-year rate of change in government spending is likely to be negligible (+0.2%). A budget surplus of +0.6% is expected for 2018 as a whole.

The central bank refinancing rate stands at 7.25%. The consensus forecast calls for the refinancing rate to decline to 6.7% by the end of the year. Thus the current rate cutting cycle seems set to continue.

Bonds	Yield Forecast Q3 2018
Euro Zone Main Refinancing Rate	0.00 %
German Bund	0.6 % (10Y)

ECB maintains easy monetary policy well into 2019

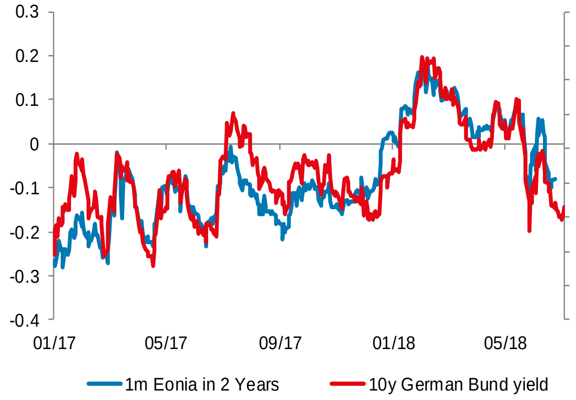
No change in ECB interest rates until after the summer of 2019

At its meeting in June the ECB Council has taken far-reaching decisions that will determine the course of monetary policy for the foreseeable future. Monthly net purchases of securities will be decreased from the current level of EUR 30bn to EUR 15bn from October onward and will be discontinued entirely after December. According to the ECB, reinvestment of the proceeds from maturing bonds held in the existing portfolio will be continued for a long time after net purchases end. We expect that this policy will be maintained for a time period of two years. From the perspective of financial markets the most important decision concerned future interest rate policy. Although the ECB Council stated that all future decisions would be data-dependent, the Council at the same time voiced its expectation that interest rates will be held at current levels at least through the summer of 2019. This is de facto a commitment, as it seems highly unlikely that future developments in the inflation rate will require an earlier rate hike by the ECB. Thus we expect to see a first rate hike (deposit facility) in September of next year, followed by a hike in the main refinancing rate in December.

Potential for increase in bond yields limited

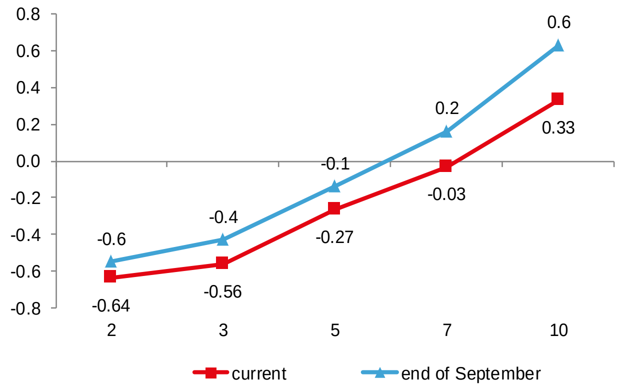
By providing this guidance on interest rates the ECB has dampened interest rate expectations in the markets and reduced uncertainty about future developments – and consequently speculation on rate increases – to a minimum for the foreseeable future. This factor is decisive for bond market trends. The chart below illustrates the importance of interest rate expectations (1-month Eonia in two years) for moves in the yield on 10-year German Bunds. Speculation on the trend in interest rates after the summer of 2019 is likely to resume by the second quarter of 2019 at the earliest. However, we don't believe that bond yields will remain at current levels that long. Currently political upheaval – the new Italian government, global trade disputes - is putting pressure on yields. At the same time the recent ECB decision has lowered the potential for increases in yields. While yields on 10-year Bunds should rise until the end of the year, they should therefore not reach levels in excess of those already seen at the beginning of the year.

Interest rate expectations decisive for bond markets
Yield on 10-year Bund, in %



Source: Bloomberg, Erste Group Research

Political risks are currently dampening yields
German yields by maturity, in %



Source: Bloomberg, Erste Group Research

US	Yield Forecast Q3 2018
Federal Funds Rate	2.00 – 2.25 %
US Treasury Notes	3.2 % (10Y)

How long will the trade dispute last?

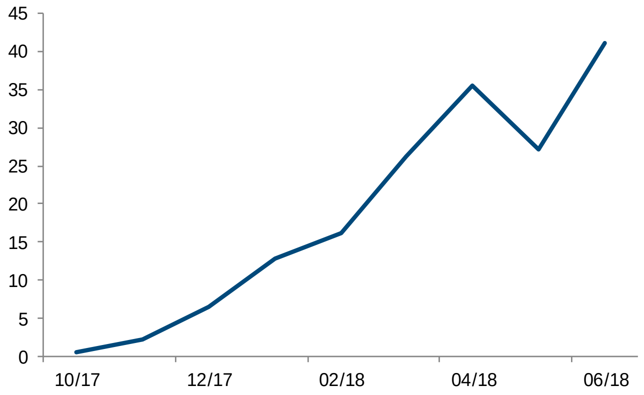
Two more rate hikes this year

Not only was the expected 0.25% hike in the range for the federal funds rate to 1.75% - 2.0% announced at the last meeting of the Federal Open Market Committee (FOMC), but the outlook was confirmed as well. The FOMC continues to assume that gradual interest rate hikes will be needed to fulfill its mandate of maintaining price stability and maximum employment. A continuation of rate hikes at a quarterly frequency appears most likely to us. Thus we expect two more rate hikes before the end of the year, in September and December, respectively. Financial markets are currently pricing in a rate hike in September, whereas they still assign a probability of significantly less than 50% to a December rate hike. However, a survey among FOMC members in June showed that a small majority expects a rate hike in December as well. For us the decisive factor is the assumption that the strong performance of the US economy will continue. In combination with an inflation rate close to the Fed's target level, the FOMC should have no reason to opt for a pause in December.

Trade crisis lends support to US treasuries

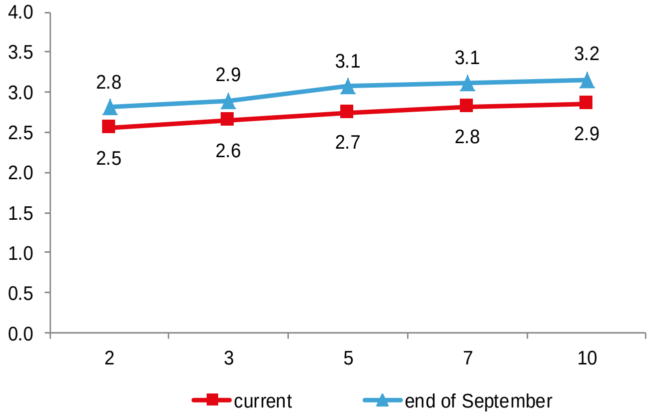
The trade policies of the US administration have led to uncertainty in financial markets, which has supported US treasuries. In mid May yields on 10-year treasury notes still stood at more than 3.10%, only to slump significantly thereafter; currently they trade close to the 2.90% level. The ultimate extent of the economic damage wrought by protectionist US trade measures cannot be reliably estimated at this juncture, just as it is impossible to predict how US trade policies will actually develop from here on out. The volume of trade currently affected by additional tariffs is in our opinion too small to noticeably affect overall economic activity. Upcoming economic data should therefore not provide any fundamental justification for the recent decline in yields, which makes it likely that the uptrend in yields will resume in coming months. However, this is definitely predicated on the Damocles sword of a further escalation in the trade dispute no longer hanging over the markets. We hope that the situation will calm down again, but we also see a risk that the campaign for the mid-term elections in November is already casting its shadow over proceedings.

Probability of a December rate hike priced in by financial markets, monthly data



Source: Bloomberg, Erste Group Research

Yields should rise somewhat in coming months
Treasury yields by maturity, in %



Source: Bloomberg, Erste Group Research

CEE Government Bonds	Yield Forecast Q3 2018
Czech Republic	1.85% (10Y)
Hungary	3.31% (10Y)
Poland	3.20% (10Y)
Romania	5.10% (10Y)

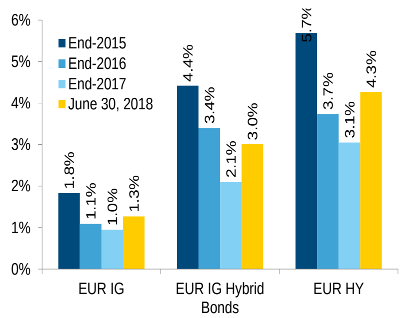
Since May of this year, we have seen increased tensions in the global market mood, which has also left its mark on CEE FXFI markets. The effect was not the same for the different CEE countries, however. As for 10Y local currency bonds, yields increased the least for Poland (around 5bp), followed by the Czech Republic (somewhat above 30bp) and Romania (more than 70bp). The strongest increase took place in Hungary, as yields increased by more than 110 basis points by June 28 in the second quarter. Hungary was hit the most, as the central bank, amid the deteriorating sentiment, silently gave up on keeping longer-term bond yields depressed, which caused yields in particular to explode (in January, 10Y yields were still below 2% in Hungary, due to central bank actions).

Fundamentals did not materially change in CEE, but as major central banks (Fed, ECB) continued to tighten monetary policy, supportive market sentiment waned for CEE bonds. Central banks in the Czech Republic and Romania already started their tightening cycle earlier to accommodate the changed environment. In the Czech Republic, the very tight labor market contributed to the central bank actions, while in Romania, local fiscal risks played a role. Poland still has a rather low level of core inflation (well below 1 percent). Therefore, central bankers are not under pressure from price developments to increase the 1.5% policy rate yet. On the other hand, the MNB, which has been pursuing an ultra-loose monetary policy for years in Hungary (with tools that include an O/N lending rate of -0.15 percent, FX swap tenders to inject liquidity into the interbank system and monetary IRS tenders at below-market rates) did not send a clear message to markets as to how and when it will start to step back from the stimulus. Even shorter-dated rates started to increase amid the sell-off of bonds and the gradual weakening of the forint. In late June, the EURHUF reached new historic highs, showing that the market continues to test what the central bank is willing to tolerate. Fundamentals would warrant a stronger forint, however, so a reverse in central bank communications could boost the local currency and perhaps also dampen longer-dated bond yields to some extent. As for the outlook on yields, some correction in Czech, Romanian and Hungarian yields could be imagined in the short run after the recent increases, but in the longer run, yields may increase again. Polish yields are not expected to correct, given the absence of any strong increase in the previous months.

EUR-Corporate Bonds
Investment Grade
High Yield

Yields rose in all segments

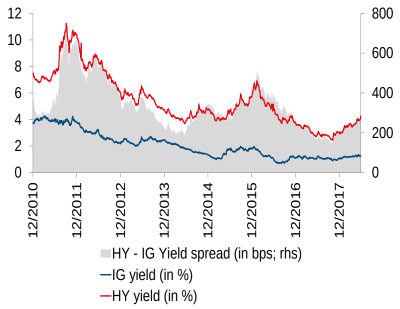
Average yields in %, average remaining term to maturity*: ~5 years



Source: Erste Group Research
As of 30 June 2018
*in the case of hybrid bonds: remaining term until the first call date

HY and IG yield spread has widened

Yields on EUR HY bonds and EUR IG bonds and the spread between them (grey area)



The difficult formation of a government in Italy, the critical stance of the new government toward the EU and/or the euro and intensifying trade disputes (US vs. China, US vs. EU) have affected the performance of corporate bonds negatively in the 2nd quarter, particularly in the high yield segment.

At the moment at least, Italy is no longer in focus. It seems the new government is not pursuing an exit from the euro zone. Hence investors have calmed down – for now. Italian issuers represent around 5% of outstanding investment grade (IG) bonds and 11% of outstanding high yield (HY) bonds denominated in EUR.

Since June 01 the US is levying tariffs on steel and aluminum imports from the EU. The direct impact on EUR-denominated corporate bonds should be negligible for the moment: the steel and aluminum sectors represent just 4% of outstanding HY bond issuance. However, there is a looming threat that US tariffs will be extended to car imports. Car makers have issued around 8% of EUR-denominated HY bonds and 10% of IG bonds outstanding. The US is an important market for many car makers, though of course not the only one.

The trend toward protectionism is increasing uncertainty among companies and investors. In June Daimler lowered its 2018 earnings guidance: higher import tariffs for US-made vehicles in the Chinese market and the associated consequences for the SUV market played a major role in this. Year-to-date the bonds of car makers delivered the weakest sector performance in the IG segment.

The trade disputes are dampening growth expectations. While the Markit euro zone PMI still rose in June - driven by the services component - the IFO business climate index for Germany fell to the lowest level since May 2017. As one would expect, the weakening of this leading economic indicator is going hand in hand with widening credit spreads in Europe.

The ECB announced on 14 June that it will halve its net purchases from October onward and likely discontinue them completely at the end of 2018. However, the central bank will continue to reinvest the proceeds from maturing bonds. Due to the remaining terms to maturity of corporate bonds it has purchased since June 2016, purchase volumes will initially decline markedly from January 2019 onward: thus “only” EUR 819mn in bonds will mature in January. By comparison, in May 2018 net purchases still amounted to around EUR 5bn. ECB publications often stressed the positive effects its corporate bond purchases exerted on corporate financing conditions. It cannot be ruled out that the ECB will partly reinvest future proceeds from maturing government bonds into corporate bonds. The recent decisions announced by the ECB should in principle continue to lend support to EUR-denominated corporate bonds.

From a fundamental perspective the outlook for the corporate sector remains quite positive: The consensus continues to expect a decline in the average net debt/EBITDA ratio of STOXX 600 Index constituents. We assume that the trade disputes won’t escalate further and continue to prefer IG hybrid and HY corporate bonds. Due to the increase in uncertainty we recommend exclusively BB rated bonds in the HY segment. In the medium to long term the expected increase in yields on German Bunds should weigh more heavily on the IG segment than on the HY segment.

Currencies

	Forecast Q3 2018
US-Dollar	1.14

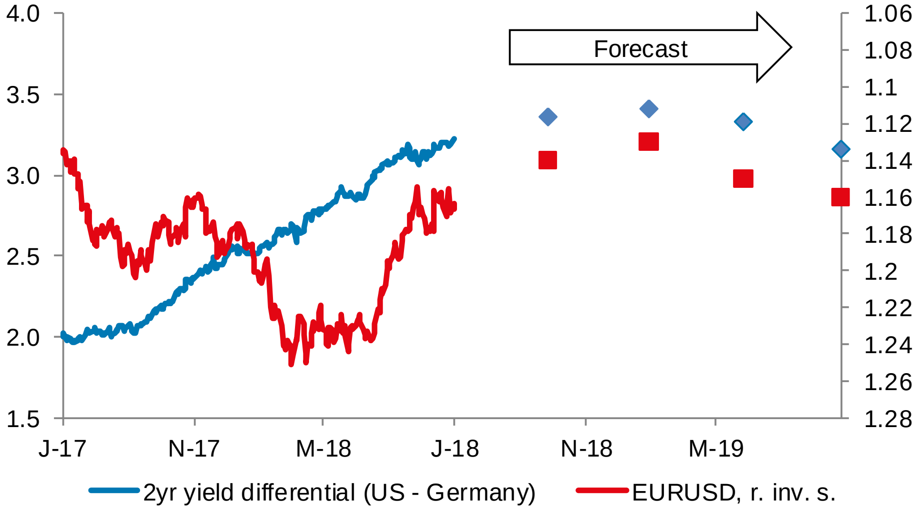
US dollar set to appreciate further

A strong rally in the US dollar started in mid April, and continued until late May. Since then EURUSD is fluctuating in a trading range between around 1.16 and 1.18. We consider this to be temporary state of affairs and see further potential for the US dollar to strengthen in coming months. The recent meetings of the FOMC and the ECB Council have confirmed our opinion regarding this outlook.

Interest rate differential between the US and the euro zone should continue to widen

At its meeting on 13 June the FOMC affirmed that US monetary policy will remain on course. Further gradual rate hikes are considered to be in line with the Fed's dual mandate of safeguarding price stability and fostering maximum employment. We believe that the quarterly frequency of rate hikes will be maintained for the rest of the year and accordingly expect that interest rates will be raised both in September and December. While a September rate hike is generally considered a done deal, the markets assign “only” a 40% probability to a rate hike in December. However, this probability should continue to rise, as upcoming US economic data releases are bound to lend further support to such a step, which should boost the US dollar as well. By contrast, the ECB Council has committed itself to refrain from raising interest rates for some time to come. Although future monetary policy decisions will continue to be data-dependent, the ECB Council expects that interest rates are likely to remain unchanged through the summer of 2019. In our opinion this means that the euro won't be supported by speculation on the trend in euro zone interest rates for a considerable period of time. The central banks have provided relatively clear guidance on their respective monetary policy stances. Thus interest rate differentials between the two economic areas are set to widen further, which suggests in our view that the US dollar will continue to appreciate.

Yield differential widens and lends support to the US dollar
Yield differential: 2 yr. US treasury note – German 2 yr. Schatz (%) vs. EURUSD



Source: Bloomberg, Erste Group Research

Forecast Q3 2018

Swiss Franc 1.16

SNB maintains its expansionary monetary policy and raises inflation forecast

At its meeting on 21 June the Swiss National Bank left the target range for three month Libor between -1.25% and -0.25%, while interest on sight deposits with the central bank was kept unchanged at a negative rate of -0.75%. After the ECB had delivered what the markets saw as rather muted guidance on interest rates, this was to be expected. Since the last monetary policy assessment in March the Swiss franc is barely changed, despite experiencing strong volatility. According to the SNB, the situation in foreign exchange markets remains fragile. Negative interest rates and the willingness of the SNB to intervene in foreign exchange markets if necessary are therefore judged to remain essential. These measures make Swiss franc investments less attractive, which mitigates upside pressure on the currency.

Due to the rally in oil prices the SNB has raised its conditional inflation forecast significantly compared to March. In 2018 the SNB expects the inflation rate to reach +0.9% (vs. +0.6% previously). The inflation forecast for 2019 remains stable at +0.9%. The estimate is based on the assumption that three month Libor will remain unchanged at -0.75% over the entire forecast horizon. According to the SNB, economic data are signaling a favorable outlook for coming months, the base case scenario of the SNB therefore assumes that the global economy will continue to grow above its potential. However, it regards the risks as skewed to the downside, with the focus on political developments in certain countries as well as the potential for growing international tensions and protectionist tendencies.

After a brief consolidation phase, the Swiss franc strengthened significantly against the euro in the wake of the formation of a populist government in Italy in mid May. The recent intensification of the trade dispute between the US and more or less the rest of the world triggered an increase in safe haven flows as well. If no further expansion in protectionist measures is implemented and/or no political tensions flare up, our base case scenario (interest rate differentials) envisages a continuation of the global economic upswing. In this environment we would expect a gradual, moderate depreciation of the Swiss franc against the euro to around 1.17 by Q4 2018. However, a minimum exchange rate is no longer enforced. Should certain risks materialize (e.g. geopolitical conflicts, intensification of the global trade conflict or turmoil in the EU) the Swiss franc could once again appreciate rapidly and strongly.

	Forecast Q3 2018
Gold in USD	1.230 – 1.280

The price of gold declined by -5.7% in USD terms in the second quarter. The response to the recent rate hike by the Fed on 13 June was markedly negative. In EUR terms the price fell by -0.1%.

Investment demand declines, central bank purchases increase

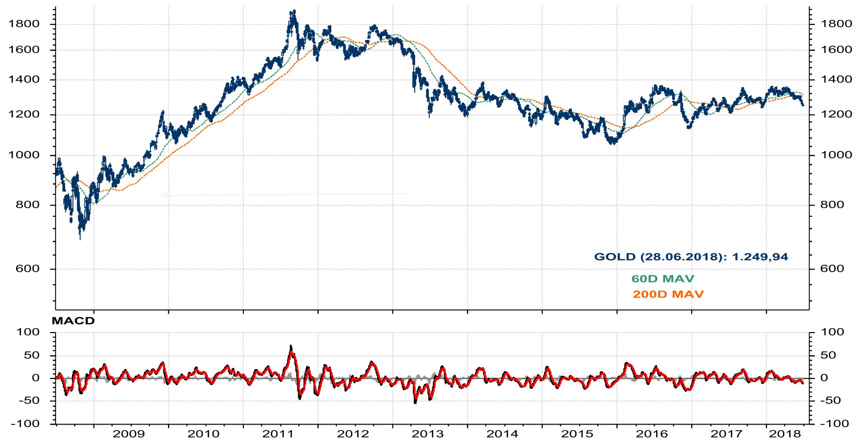
According to the World Gold Council gold demand has declined by 7% y/y in the first quarter to 974 tons. The downtrend in investment demand continued (-66%). However, the situation changed at the beginning of the second quarter and demand in both the US and Europe strengthened again.

Global sales of gold bars and coins amounted to 255 tons, a 15% decline compared to the previous year. The decline was particularly pronounced in the US (-59% y/y) and Europe (-39%). By contrast, gold demand on the part of central banks increased in the first quarter. Their purchases totaled 117 tons (+42% y/y).

With respect to the outlook for the trend in gold prices several important factors have to be considered. Rising volatility in stock markets, tensions between the US and its trading partners as well as Russia are boding well for the investment demand for gold.

On the other hand, the US stock market so far remains stable despite heightened volatility and corporate earnings continue to grow. Moreover, real yields in the US are increasing, which is putting pressure on the gold price. Real yields on two year treasury notes are already in positive territory. The Fed is likely to hike rates two more times this year, which should continue to push up real interest rates. A likely moderate appreciation of the US dollar should exert a negative effect on gold prices as well.

Gold in USD



Source: Datastream, Erste Group Research

Outlook
There is a high probability that the Fed will implement two further rate hikes this year in view of the strong performance of the US economy. In an environment of rising real interest rates a sustainable rally in the gold price appears unlikely. **Thus we expect prices to trade in a range from USD 1,230 to 1,280 in the third quarter.**

Stocks

Forecast Q3 2018

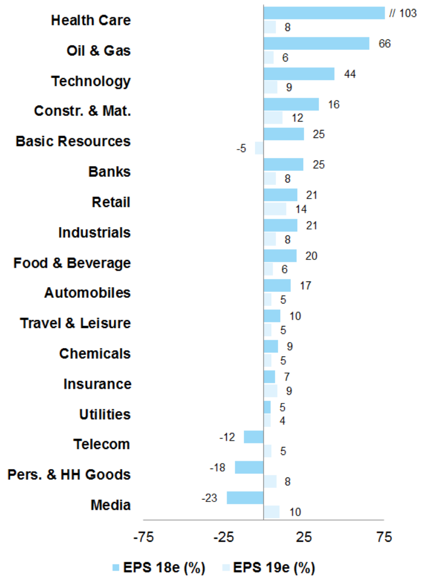
Global — 0% to +5%

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

Indices	Sales		EPS	
	18e	19e	18e	19e
North America	8.4	4.6	34.5	8.9
Europe	7.0	-0.8	17.7	4.3
Asia	4.9	1.5	10.0	2.8
EM Asia	11.2	9.1	13.7	12.1
EM LatAm	8.2	-3.4	65.6	1.8
EM Europe	18.5	-4.4	34.6	-2.0
World	**7.8**	**2.7**	**24.0**	**7.0**

Source: Erste Group Research Index, FactSet.

Global sectors
Earnings expectations (y/y, %)



Source: Erste Group Research Index, FactSet.

Global benchmark indexes posted a gain of around +3% in USD terms last quarter (+9% in EUR terms). The US stock market exhibited relative strength. The global emerging markets index underperformed its developed markets counterpart substantially. This was primarily due to weakness in many emerging market currencies.

Earnings and revenue growth in 2018

According to consensus estimates, the outlook for corporate earnings and revenue growth on the global level remains positive. Revenue growth of the 1,000 largest companies in the world is expected to reach +7.8% this year. Revenue growth of +8.4% is expected in the US. The estimates for revenue growth in Europe (2018e: +7%) and Japan (2018e: +3.9%) are lower, while estimates for emerging markets are higher (2018e: +11.8%).

Earnings growth of the largest global companies is likely to reach +24% this year. Expected earnings growth rates for listed US companies exceed those for European or Japanese ones. According to consensus forecasts earnings are set to continue to grow globally in the coming year (2019e: +7%). Growth in the US is once again likely to be more pronounced than in Europe. In view of this important market driver, European stocks are plainly less attractive.

The current trade dispute between the US, Europe and China will probably lead to heightened market volatility in coming months. The effects are likely to be particularly noticeable in European stock markets, as well as in a number of emerging markets.

Valuation slightly above the historical average

The 2018 forward P/E ratio of the global stock market index stands at around 15.3x (2019e: 14.3x). The 2018 forward dividend yield amounts to 2.5%. In light of positive growth prospects this valuation appears appropriate. The higher valuation of the US stock market (2018 forward P/E: 17.7x) compared to Europe (2018 forward P/E: 14.3x) is justified by the fact that US companies can boast of stronger profitability, as well as higher long-term earnings and revenue growth rates.

Stocks remain attractive relative to bonds.

The global developed market bond index currently has a yield-to-maturity of 1.33%. Bond investors have to expect a moderate rise in yields that will result in a slight decline in bond prices. By contrast, the dividend yield of the global stock index is almost twice as high as the yield on the global bond index. Moreover, based on earnings growth estimates, there is a realistic possibility that stocks will generate price gains as well.

Outlook

Due to the trade dispute between the US and its trading partners uncertainty has increased. As long as this situation persists, the stock market indexes of developed markets should continue to outperform those of emerging markets. The US stock market in turn should continue to exhibit relative strength compared to the European stock market. **We expect global stock indexes to post a gain in a range of 0% to +5% amid elevated volatility.**

Global Sectors (1)

Outlook:	↗	0 to +5%
PE 18e		12,3x
EPS 18e		+66,1%

Energy

The energy sector index is exhibiting relative strength vs. the global stock index. According to consensus estimates the earnings of companies in this sector are set to grow by +66% this year. Next year earnings growth is expected to slow to +6.1%. Revenues are estimated to increase by +18.7% this year and stagnate next year (-0.1%). What argues in favor of this sector despite its lack of long-term growth is its above-average dividend yield of 3.9%. We expect the sector index to generate a positive return in the third quarter and gain between 0% and +5%.

Outlook:	↘	-5% to 0
PE 18e		15.1x
EPS 18e		+9.1%

Chemicals

The global chemical sector exhibited moderate relative weakness vs. the broad global stock index in the second quarter. A major reason for this was that expectations of earnings and revenue growth for companies in this sector are muted. This year analyst estimates are calling for earnings growth of +9.1% followed by +4.8% next year. Revenues are likely to increase by just +1.8% in 2019. We expect the sector's relative weakness to persist and are forecasting a decline in a range from -5% to 0%.

Outlook:	↘	-5% to 0
PE 18e		11.3x
EPS 18e		+25.2%

Commodity producers

Most commodity prices fell in the second quarter. Prices of industrial metals and food commodities weakened in particular. The sector index nevertheless managed to eke out a gain that slightly exceeded the performance of the world stock index last quarter. Consensus estimates are calling for earnings growth of +25.2% for the sector this year, followed by an earnings decline of -5.1% in 2019. We expect the sector to deliver a moderately negative performance in the 3rd quarter in a range from -5% to 0%.

Outlook:	↗	0 to +5%
PE 18e		20,0x
EPS 18e		+34.5%

Construction & Building Materials

This sector achieved a positive performance in the second quarter. Consensus estimates are calling for revenue growth of +10.8% in 2018 followed by +2% in 2019. Earnings per share are expected to increase by +11.9% in 2019. Earnings of US companies are expected to grow at almost twice the pace of those of European firms. We expect the sector index to post a gain in the third quarter at the lower end of a range from 0% to +5%.

Outlook:	↗	0 to +5%
PE 18e		17.2x
EPS 18e		+21,0%

Industrial Goods & Services

According to consensus estimates top-line growth in the sector will amount to +7% in 2018 followed by +3.5% in 2019. Earnings are expected to grow by +21% this year and by +7.6%next year. US industrial companies should exhibit significantly stronger growth in earnings per share this year (+33.6%) than their European counterparts (+1.8%). Thus the outlook for US companies is especially positive. Relative strength in their stocks should be maintained. We expect the sector index to deliver a positive return in a range of 0% to +5% in the third quarter.

Outlook:	↘	-5% to 0
PE 18e		9.8x
EPS 18e		+17,0%

Car Manufacturers & Car Parts Suppliers

The automotive sector underperformed the world stock index last quarter. The differences between individual countries and regions were extraordinarily large though. Shares of US car makers rose by +25.2% in EUR terms, while the sector indexes of European and Asian manufacturers moved sideways. The possible introduction of tariffs on US car imports would be detrimental for numerous EU and Asian companies and weigh on their profit margins. Globally the sector should report below average earnings growth of +4.8% next year and revenue growth of just +1.2%.

Global Sectors (2)

Outlook:	↘ -5% to 0
PE 18e	20.9x
EPS 18e	+20.4%

Food & Beverages

The sector index declined in the second quarter (-3.3%). Shares of US producers as well as those of their European competitors suffered price declines on average. The performance of the European sector index was weaker than that of its US counterpart in this case as well. Revenues are expected to grow by +4.2% in 2018 followed by +1.9% next year. These are not particularly inspiring prospects for shareholders. We expect the sector index to lose ground again and post a decline in a range from -5% to 0%.

Outlook:	↗ 0 to +5%
PE 18e	21.2.0x
EPS 18e	+-17.8%

Household & Personal Care Products

This sector delivered a positive performance last quarter (+8.9%). Consensus estimates are calling for revenue growth of +7.1% this year and +3.7% in 2019. Expected earnings growth in 2019 amounts to +7.9%. This is slightly above the broad global stock index average of +7%. The outlook for US companies is slightly better in this respect (2019e: +9.2%) than that for European firms (2019e: +5.3%). We expect the sector to advance between 0% and +5% in the third quarter.

Outlook:	↗ 0 to +5%
PE 18e	16.9x
EPS 18e	+103%

Health Care & Pharmaceuticals

The sector index rose by +10.4% in EUR terms last quarter. US health care companies posted a gain of +12.8%, while European companies rallied by +4.5%. As Europe enjoys a large export surplus in drugs with the US, the sector may become a target for punitive tariffs. According to consensus estimates global revenues are going to increase by +4.5% in 2019, while earnings growth will amount to +7.8%. The outlook for European companies is below-average (revenues 2019e: +0.3%, earning/share: +2.5%). We expect the sector to gain between 0% and +5% in the third quarter, with shares of US companies outperforming.

Outlook:	↗ 0 to +5%
PE 18e	28.3x
EPS 18e	+21.1%

Retail Trade

According to consensus estimates, sales are expected to grow by +5.7% in 2019, while earnings growth will reach +14.0%. The outlook for US-based companies is stronger than that for European ones, both with respect to revenues and earnings. We expect the sector to post a gain in a range from 0% to +5% in the third quarter, with US-listed stocks outperforming.

Outlook:	↗ 0 to +5%
PE 18e	47.7x
EPS 18e	-22.9%

Media

The outlook for this sector is positive. Next year revenues are expected to increase by +3.9% and while earnings growth should reach +10%. Most of this growth is likely to be generated by US companies. We expect the sector to rally in the 3rd quarter (0% to +5%) and believe that US stocks will outperform in this sector as well.

Outlook:	↗ 0 to +5%
PE 18e	15.4x
EPS 18e	+10.4%

Travel & Leisure

According to consensus estimates revenues in the sector should grow by +6.5% in 2018, followed by +4.6% in 2019. An earnings growth rate of +10.4% is expected for 2018. In this sector US companies will also generate the bulk of next year's earnings growth, while earnings of European firms are expected to stagnate (+0.8%). We expect the sector index to advance between 0% and +5% in the third quarter.

Global Sectors (3)

Outlook:	↗ 0 to +5%
PE 18e	18,0x
EPS 18e	+44.4%

Technology
The technology sector has achieved an above-average performance since the beginning of the year, as well as in the second quarter (+15.7%). Investors are benefiting from strong revenue and earnings growth in the sector. According to consensus estimates revenues of technology stocks will grow by +11% in 2018. After posting very strong growth in earnings per share this year (+44.4%), a further increase by +8.5% is expected in 2019. Earnings of European companies in this sector should grow by +11,5% next year, those of US companies by +8.9%. We expect the sector to post a positive performance ranging from 0% to +5% in the third quarter.

Outlook:	↘ -5% to 0
PE 18e	15.1x
EPS 18e	+4.5%

Utilities
Consensus estimates for sector-wide revenue growth are calling for a decline by -0.4% in 2019. Revenues of US utilities should increase moderately in 2019 (+3.0%), but fall at European companies (2019e: -2.4%). With respect to earnings growth US companies are in a more favorable situation as well. Their earnings per share are forecast to grow by +7.3% in the coming year, while earnings of European utilities are expected to contract by -2.5%. This sector is unattractive due to its lack of innovation. We expect a moderately negative performance in the third quarter; the sector should post a decline between -5% and 0%.

Outlook:	↘ -5% to 0
PE 18e	13x
EPS 18e	-12,0%

Telecommunication
This sector has lost ground since the beginning of the year (-4.6% in EUR terms). The outlook for the sector is below average. According to consensus estimates revenues should increase by +3.1% this year and stagnate next year (-0.1%). Earnings per share are expected to decline by -12% this year and rise by +5.1% next year. We expect the telecom index to post a decline ranging from around -5% to 0% in the third quarter.

Outlook:	↗ 0 to +5%
PE 18e	9.7x
EPS 18e	+25,0%

Banks
Consensus estimates indicate that the banking sector is likely to achieve growth in earnings per share of +25% this year, followed by a slowdown in the coming year. The growth rate currently expected in 2019 amounts to +7.5%, which moderately exceeds the average earnings growth rate estimate for the world stock index as a whole. Valuations in the sector are low: the 2018 forward P/E ratio stands at 9.7x, coupled with a 2018 forward dividend yield of 3.9%. We expect the sector to post a gain at the lower end of a range from 0% to +5% in the third quarter.

Outlook:	↗ 0 to +5%
PE 18e	10.7x
EPS 18e	+7,0%

Insurance
According to consensus estimates the insurance sector will report a decline in revenues of -11.5% this year. Next year revenues are expected to rise by +3.3%. However, earnings growth estimates for the sector look better. Earnings per share are expected to grow by +7% this year followed by +8.5% next year. We expect the sector index to generate a positive return in the third quarter in a range from 0% to +5%.

Forecast Q3 2018

Europe 0% to +5%

Europe consensus estimates
Earnings and sales growth (y/y, %)

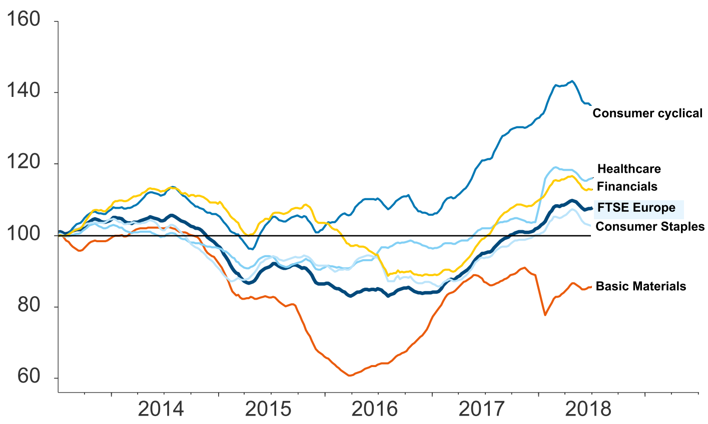
Indices	Sales		EPS	
	18e	19e	18e	19e
UK	0.2	-1.0	2.4	4.4
Switzerland	7.8	-0.8	73.6	5.8
France	8.0	-0.3	13.8	5.7
Germany	8.4	-0.7	11.8	4.3
Spain	12.1	-1.4	26.6	3.4
Europe	**7.0**	**-0.8**	**17.7**	**4.3**

Source: Datastream

The European Stoxx 600 Index rose by 3% in EUR terms in Q2. Most sectors delivered positive returns. The strongest gains were posted by the retail, oil & gas and technology sectors. The commodities sector, which is only partly affected by the imposition of tariffs by the US achieved an above-average return as well (+6%). Negative performances were recorded by the sector indexes for car makers, banks, insurance companies and telecommunication firms.

Consensus estimates for sales and earnings growth in 2018 continue to be positive. Revenues are expected to grow by +7% this year; earnings are expected to grow even more strongly. The listed European corporations with the largest market capitalization are estimated to achieve earnings growth of +17.7%. Consensus estimates for 2019 are calling for stagnation in revenues (-0.8%). Earnings are therefore also expected to grow more slowly than this year (+4.3%). This is primarily due to the fact that according to consensus estimates growth in the energy sector (oil & gas) is set to slow down. This sector has a sizable weighting in European benchmark indexes.

Earnings estimates for European market sectors
Earnings per share indexed; 2013 = 100



Source: Datastream, Erste Group Research

The market's valuation based on the 2018 forward P/E ratio stands at 14.3x, for next year the forward P/E ratio amounts to 13.7x. The forward dividend yield stands at 3.6%, which is above the global average. Thus the stock market's valuation is favorable. This is likely to remain the case in the long term, because the profitability of European corporations (e.g. as measured by return on equity) is not only far lower than that of US companies, but also lower than that of listed companies in emerging markets (RoE Europe 2018e: 9.9%; US: 18.3%; emerging markets: 12.7%).

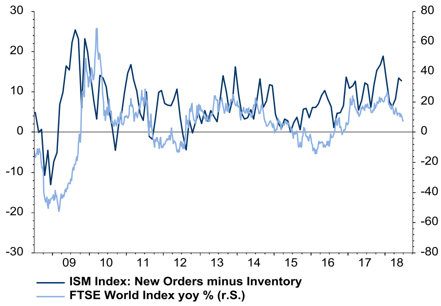
Outlook

We expect volatility in European stock markets to continue in the third quarter. The earnings prospects for companies are positive, but weaker than in the US. European stock markets should therefore generate lower returns than US markets. We expect the European benchmark index to post a gain at the lower end of a range from 0 to +5%.

Forecast Q3 2018

USA 0% to +5%

US new manufacturing orders minus inventories vs. one-year rate of change of the global stock index



Source: Datastream, Erste Group Research

The US benchmark stock indexes posted gains in the 2nd quarter. The S&P 500 Index rallied by +2.9%, the Nasdaq 100 Index advanced by +6.8%. Volatility eased in the course of the quarter, but remains above the average of the previous year. The imposition of tariffs by the US administration contributed to a temporary bout of uncertainty among investors.

The economy continues to perform well. The ISM manufacturing index recently reached 60.2 points, signaling an ongoing expansion in the US manufacturing sector. The difference between new orders and inventories is an important leading indicator for the economy and the stock market. This metric has increased and shows that companies continue to enjoy healthy order books. The services sector is expanding as well. The services PMI currently stands at 58.6 points, significantly above the neutral level of 50 points.

Corporate revenues and earnings are expected to grow strongly this year. Recent consensus forecasts are calling for revenue growth of +8.4% in 2018. Earnings per share are estimated to grow by +36.3%. The positive trend is expected to continue next year as well. Revenues are projected to grow by +4.8% in 2019, while earnings per share are expected to increase by +9.1%. Companies are evidently enjoying a period of robust growth.

The forward P/E ratio of the US stock market stands at 17.7x this year and 16.2x in 2019. The forward dividend yield of the S&P 500 Index amounts to 1.9%. Profits seem set to increase and dividends are likely to follow suit.

The yield on the 10-year US Treasury note currently stands at around 2.9%. Since bond yields are likely to rise somewhat, bonds should be expected to suffer price declines. By contrast, companies are in an environment of strong growth and stock market conditions appear sound. US stocks therefore continue to be more attractive than US government bonds.

Outlook
The expected continuation of corporate earnings growth suggests that the stock market will post additional moderate gains. In view of high corporate profitability, the strong innovative capacity of listed companies and its large size, the US stock market remains the most attractive market in the world. The trade dispute with China and the EU could lead to an intermittent surge in volatility. **We expect the market to deliver a positive performance in the third quarter and generate a return in a range of 0% to +5%.**

Forecast Q3 2018

CEE ↗ 0% to +5%

Generally rising yields might have been digestible even for emerging markets if economic outlook would be compensating. Instead, increasing political uncertainty and especially trade tensions have been adding to the worsening sentiment and growth outlook is getting weaker. Although the impact of the trade issues is hard to quantify, it will get more severe the longer the uncertainty prevails. Correlations among regions and asset classes are increasing, making current uncertainty an issue for all markets, not only for EM. Depressed markets, with rising volatility and a substantial deterioration of fund flows / allocations for emerging markets, have been a result. Changes in major benchmarks might have some immediate negative liquidity impact for the region and Poland.

With the elections behind it, political discounts for Turkey might be removed and the market might enjoy a relief rally. Still, we remain cautious, as issues such as high levels of external debt against a massively weaker TRY remain. Turkish banks should be in the spotlight, both for external debt risk, but also as beneficiaries of any relief rally.

Cyclical rotation continues, heading out of boom territory. The growth outlook for EM overall is getting weaker, but we still expect solid numbers for CEE. Continuing an ultra-loose monetary policy should continue to weigh on the HUF. Relying mostly on GDP growth to reduce relative public debt figures might finally put a spell on investments for HU, RO.

EPS trends are deteriorating across the board, while CEE still keeps relative strength at least in FY 2018 earnings. While absolute y/y earnings growth for the region remains nascent, earnings growth momentum is tangible, quite in contrast to most other global regions.

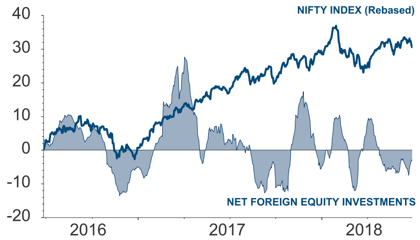
The current uncertainty might ask for increasing exposure to defensive sectors. However, the consensus indicates a generally weak trend for EPS for all sectors, while cyclicals even show some recovery in 2019 EPS trends. While utilities indeed show some signs of life and would fit more with a cyclically-oriented sector rotation, banks show interesting earnings growth momentum as well and are mostly attractively valued. We would still not rely on a traditional sector rotation, but would rather take advantage of opportunities as they arise.

Poland should finally be ready to bottom out, but its lasting negative trend this year will be hard to overcome. Turkey is our speculative bet, while conservatively we should remain neutral on that market. We continue to like Hungary and the Czech Republic and remain optimistic on Romania, while concerns on the future of the latter’s pension funds could spoil the show. Austria should be a stock picking issue.

Forecast Q3 2018

India 0% to +5%

India: net change in foreign investor capital flows into Indian equities vs. the Nifty Fifty Index



Source: Datastream

The Indian stock market rose by +10% in EUR terms in the 2nd quarter. From the end of April onward, net outflows of foreign capital resumed. The benchmark Nifty Fifty Index subsequently entered a sideways trading range, while weakness in the Indian rupee against the USD persisted despite a surprise rate hike by the Reserve Bank of India.

Consensus estimates for growth in earnings per share compared to other emerging markets in the Asia-Pacific region are well above average. Expected earnings growth for 2018 stands at +17.2%, followed by an estimated +17.6% for 2019.

The 2018 forward P/E ratio amounts to 18.8x. The forward dividend yield of listed Indian corporations for this year stands at an average of 1.7%. These metrics represent a valuation premium compared to other emerging markets. The reasons for this are primarily India's strong growth momentum and high corporate profitability (RoE 2018e: 14.2%).

Outlook
We expect that the Indian stock market will achieve a moderately positive performance in Q3 2018. We are therefore looking for it to post a gain in a range from 0% to +5%.

Forecast Q3 2018

China | Hong Kong 0% to +5%

China:
IFO Indexes

Source: Datastream

The Chinese stock market rallied in the course of last quarter, posting a gain of +7% in EUR terms. China's economic surprise index has deteriorated in recent weeks and has entered negative territory; this indicates that the bulk of economic data has come in below expectations. While the current economic conditions component of China's IFO Index remains positive so far, the future business expectations component has turned down. The US administration's plan of imposing tariffs on numerous Chinese goods is weighing on sentiment.

Expectations for corporate revenue and earnings growth remain positive. Consensus estimates are calling for revenue growth of +13.8% in 2018, followed by +10.4% in 2019. Earnings per share are expected to grow by +13.3% this year and +11.6% next year.

The valuation of the stock market (including Hong Kong) in terms of the 2018 forward P/E ratio stands at 11.3x. The 2018 forward dividend yield amounts to 3%. In view of the strong growth prospects cited above, the valuation of the stock market is quite favorable. Thus the long-term risk-reward ratio remains positive.

Outlook
We expect that the ongoing trade dispute with the US will exacerbate stock market volatility in the third quarter. The market should deliver a return near the lower end of a range from 0% to +5%.

Forecast Q3 2018

Brazil

-5% to 0%

Brazilian real vs. USD: losing ground
BRL/USD

Source: Datastream, Erste Group Research

The Brazilian stock market slumped by -25% in EUR terms in the second quarter. Weakness in the Brazilian real exacerbated the market's losses in euro terms. Price declines in the financial and energy sectors were particularly pronounced.

Political uncertainty has increased. The political and economic environment last quarter was characterized by a nationwide strike in the transportation sector and a major corruption scandal. It seems increasingly likely that a populist politician will win the presidential election in October. This is making investors nervous, as the current president is regarded as a proponent of economic liberalism. According to central bank data, investors reduced their exposure to Brazilian stocks in May and June. Moreover, the Brazilian real weakened substantially versus the US dollar.

The outlook for companies has deteriorated in the course of the quarter. According to consensus estimates, earnings growth is likely to amount to a mere +0.9% in the coming year. Revenues are expected to decline by -4.9%. The low valuation of the stock market (2018 forward P/E ratio: 8.6x, 2018 forward dividend yield: 4.4%) reflects the deterioration in growth prospects. A near-term change in this situation is not in sight.

We expect therefore that the stock market will remain very volatile. Brief technical rebound attempts appear likely in the wake of the recent severe slump, but will probably fail to reverse the market's overarching downtrend. **The market should post a negative return in a range of -5% to 0% in the third quarter.**

Forecast Q3 2018

Russia

0% to +5%

Russia: RTS Index vs. the oil price

Source: Datastream, Erste Group Research

The Russian stock market fell by -1% in EUR terms in the second quarter. New US sanctions triggered a decline in the index at the beginning of the quarter. The sanctions are primarily impacting Rusal, the second-largest aluminum producer in the world. Its shares continue to be suspended from trading. The increase in uncertainty had a negative effect on the financial sector as well. Shares of Sberbank, the index constituent with the largest weighting in the RTS Index, fell by -20% in EUR terms last quarter.

After strong revenue and earnings growth this year (2018e: revenues +19.5%, earnings +39.2%), the focus of investors will likely shift to the coming year. The outlook for revenue and earnings growth in 2019 has deteriorated. Consensus estimates are calling for revenues to fall by -5.4% in 2019. Earnings per share are expected to decline by -2.0%.

The market currently offers a dividend yield of 6.1% and the 2018 forward P/E ratio stands at 5.3x. Due to its favorable valuation we currently expect little change in the Russian benchmark index, despite the likelihood of a moderate decline in earnings next year. In the third quarter the index should post a gain near the lower end of a range from 0% to +5%.

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**	**2.3**	2.2	1.6	1.7	9.7	9.3	3.1	2.9	-1.7	-1.4	91.0	89.8
	Germany	**2.2**	2.1	1.5	1.7	4.5	4.6	8.1	7.7	0.1	0.2	65.9	63.6
	France	**1.7**	1.7	1.0	1.1	9.6	9.3	-0.4	-0.3	-3.0	-2.7	97.8	97.9
	Spain	**2.3**	2.1	1.0	1.1	18.0	17.0	1.7	1.7	-3.1	-2.7	100.2	100.0
	Italy	**1.4**	1.6	0.5	0.8	11.2	10.8	1.9	1.5	-2.2	-1.3	133.4	132.0
	Austria	**2.9**	2.2	2.1	1.9	5.2	5.1	2.3	2.6	-0.4	0.0	74.5	70.9
	UK	**1.5**	1.4	2.5	2.6	5.2	5.4	-4.3	-3.9	-2.7	-2.2	88.8	88.6
	Switzerland	**2.4**	1.6	0.9	0.9	2.6	3.0	9.0	8.9	-0.3	-0.2	43.7	42.6
Eastern Europe	**Russia**	**1.1**	1.2	5.0	4.5	5.9	5.5	3.5	3.9	-1.5	-0.8	17.9	18.6
	Poland	**4.6**	3.3	1.7	2.2	6.5	6.7	-0.3	-0.9	-2.3	-2.2	50.2	49.7
	Turkey	**3.0**	3.2	8.2	6.8	10.2	10.0	-5.6	-5.6	-1.6	-1.5	30.8	30.1
	Czech Rep.	**3.6**	3.1	2.1	2.0	2.3	2.5	0.6	0.5	0.2	0.2	31.9	30.4
	Romania	**4.1**	3.4	4.7	3.3	4.9	5.0	-4.0	-4.4	-3.4	-2.9	34.8	36.4
	Hungary	**4.0**	3.3	2.6	3.5	3.9	3.9	2.1	2.0	-2.2	-2.3	72.5	70.9
	Slovakia	**3.9**	4.2	2.5	2.3	6.9	6.4	-1.2	-0.5	-1.0	-1.3	49.7	47.9
Americas	**USA**	**2.8**	2.2	2.2	1.9	4.8	4.7	-2.7	-2.8	-3.7	-3.3	108.4	107.9
	Canada	**1.9**	2.0	2.1	2.1	7.1	6.9	-3.1	-2.8	-2.3	-2.0	90.5	88.7
	Brazil	**0.2**	1.5	5.4	4.8	11.5	11.1	-1.3	-1.5	-9.1	-8.0	82.4	85.2
	Chile	**2.0**	2.7	3.0	3.0	7.6	7.2	-2.4	-2.6	-2.9	-2.0	23.3	25.0
	Mexico	**1.7**	2.0	3.3	3.0	3.9	3.8	-2.8	-3.0	-3.0	-2.5	56.1	55.8
	Argentina	**2.7**	2.8	23.2	19.0	8.5	8.3	-3.2	-3.6	-7.4	-6.6	50.7	51.2
	Colombia	**2.7**	3.8	4.1	3.0	9.6	9.0	-4.2	-3.9	-2.1	-1.6	47.0	45.7
Asia	**China**	**6.5**	6.0	2.3	2.4	4.1	4.1	1.6	1.4	-3.3	-3.0	49.9	52.6
	Japan	**0.8**	0.5	0.5	0.6	3.2	3.2	3.3	3.3	-5.1	-4.4	253.0	254.9
	India	**7.2**	7.7	5.2	5.3	na	na	-2.0	-2.2	-6.6	-6.2	67.2	65.6
	Indonesia	**5.3**	5.5	4.2	4.4	5.7	5.6	-2.3	-2.4	-2.6	-2.8	28.2	29.2
	South Korea	**3.0**	3.1	1.9	2.0	3.3	3.3	5.9	5.6	1.1	1.6	39.2	38.8
	Thailand	**3.3**	3.1	1.6	1.9	0.7	0.7	7.7	5.9	-0.4	-0.5	44.3	45.1
	Australia	**2.7**	2.9	2.1	2.4	5.7	5.6	-3.9	-4.1	-2.5	-1.7	43.2	43.5
	South Africa	**0.8**	1.6	6.0	5.5	27.0	27.4	-3.2	-3.5	-3.9	-3.7	53.3	54.6
	World	**3.4**	3.6										

Source: IMF, EU Commission, Erste Group Research estimates

Forecasts[1]

GDP	2015	2016	2017	2018	2019
Eurozone	2.0	1.8	2.4	2.3	2.2
US	2.9	1.5	2.3	2.8	2.2

Inflation	2015	2016	2017	2018	2019
Eurozone	0.1	0.2	1.5	1.6	1.7
US	0.1	1.2	2.2	2.2	1.9

Currency	current	Sep.18	Dec.18	Mar.19	Jun.19
EURUSD	1.17	1.14	1.13	1.15	1.16
EURCHF	1.16	1.16	1.17	1.18	1.19

Interest rates	current	Sep.18	Dec.18	Mar.19	Jun.19
ECB MRR	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.32	-0.30	-0.30	-0.30	-0.30
Germany Govt. 10Y	0.32	0.60	0.80	0.90	1.00
Swap 10Y	0.88	0.90	1.10	1.20	1.30

Interest rates	current	Sep.18	Dec.18	Mar.19	Jun.19
Fed Funds Target Rate*	1.91	2.13	2.38	2.63	2.88
3M Libor	2.34	2.40	2.70	2.90	3.20
US Govt. 10Y	2.87	3.20	3.30	3.50	3.50
EURUSD	1.17	1.14	1.13	1.15	1.16

*Mid of target range

Interest rates	current	Sep.18	Dec.18	Mar.19	Jun.19
Austria 10Y	0.59	0.80	1.00	1.10	1.20
Spread AT - DE	0.27	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	Market Cap.	Weight (%)	Performance (%) EUR					Growth (%, y/y) Sales		Net Profit		P/Sales	Ratio P/E		DivYield
		Companies	(bn EUR)	World	1M	3M	6M	12M	YTD	18e	19e	18e	19e	18e	18e	19e	18e
	World	**1000**	**42,333**	**100.0**	**1.5**	**6.2**	**5.8**	**11.0**	**6.8**	**7.8**	**2.7**	**24.0**	**7.0**	**1.7**	**15.3**	**14.3**	**2.5**
	Developed Markets	849	35,287	83.4	2.1	6.7	5.8	11.4	7.1	7.2	2.2	24.8	6.6	1.6	15.6	14.7	2.5
	Emerging Markets	151	7,046	16.6	-1.8	3.3	5.1	8.1	4.6	11.8	5.4	20.8	9.1	1.9	13.9	12.8	2.6
Developed Markets	**North America**	**437**	**21,837**	**51.6**	**3.7**	**8.1**	**7.3**	**14.4**	**9.4**	**8.4**	**4.6**	**34.5**	**8.9**	**2.1**	**17.5**	**16.0**	**2.0**
	Canada	38	1,044	2.5	-1.3	8.7	-0.2	5.6	-1.3	6.9	1.5	11.5	5.2	1.7	13.7	13.0	3.1
	USA	399	20,793	49.1	4.0	8.1	7.7	14.8	10.0	8.4	4.8	36.3	9.1	2.1	17.7	16.2	2.0
	Europe	**239**	**8,686**	**20.5**	**-0.9**	**3.9**	**1.5**	**3.1**	**1.6**	**7.0**	**-0.8**	**17.7**	**4.3**	**1.2**	**14.3**	**13.7**	**3.6**
	Austria	2	32	0.1	-6.1	-3.9	2.8	12.9	-1.7	76.7	-8.5	95.0	11.2	0.7	9.6	8.7	3.6
	Belgium	5	238	0.6	3.6	-6.8	-7.3	-11.6	-6.9	6.7	-0.6	13.8	5.6	3.0	17.7	16.8	4.2
	Denmark	11	258	0.6	-3.4	-1.4	-3.3	-0.2	-4.9	15.9	0.5	19.3	0.0	2.5	17.4	17.4	2.6
	Finland	7	138	0.3	0.1	7.9	14.7	11.6	14.3	6.3	-1.6	65.2	4.6	1.9	17.9	17.1	4.3
	France	50	1,849	4.4	-0.6	6.5	7.1	11.6	7.7	8.0	-0.3	13.8	5.7	1.2	15.2	14.4	2.9
	Germany	33	1,311	3.1	-0.7	2.5	-2.2	1.2	-0.9	8.4	-0.7	11.8	4.3	0.8	12.7	12.2	3.0
	Ireland	8	176	0.4	7.4	9.8	10.1	-3.9	11.3	7.5	2.6	286.3	4.4	2.0	14.2	13.6	1.7
	Italy	11	347	0.8	-6.1	0.1	4.0	12.7	5.5	6.7	-1.8	3.7	5.6	0.8	11.7	11.1	4.2
	Netherlands	15	562	1.3	0.8	5.1	3.2	9.9	4.4	6.6	-1.4	3.1	-0.8	1.3	16.3	16.5	2.8
	Norway	4	194	0.5	2.6	17.7	15.8	31.4	15.1	21.3	0.1	22.7	3.8	1.4	13.8	13.3	4.0
	Portugal	2	25	0.1	-3.9	6.5	8.8	15.0	10.2	7.8	0.5	-9.8	6.5	0.8	16.8	15.8	4.5
	Spain	14	479	1.1	-1.5	2.2	-2.7	-8.4	-1.2	12.1	-1.4	26.6	3.4	1.4	13.1	12.7	4.3
	Sweden	11	240	0.6	-1.3	-2.5	-4.0	-10.4	-4.3	5.1	-2.9	41.4	0.4	1.8	13.7	13.7	4.9
	Switzerland	22	1,032	2.4	-1.5	-0.8	-6.0	-6.3	-6.0	7.8	-0.8	73.6	5.8	1.5	15.9	15.0	3.7
	United Kingdom	44	1,803	4.3	-1.9	6.6	2.1	2.2	0.4	0.2	-1.0	2.4	4.4	1.3	13.4	12.9	4.6
	Asia/Pacific	**173**	**4,764**	**11.3**	**0.4**	**4.1**	**4.8**	**10.7**	**4.7**	**4.9**	**1.5**	**10.0**	**2.8**	**1.1**	**12.0**	**11.6**	**2.9**
	Japan	107	2,915	6.9	1.0	4.9	4.4	10.1	5.3	3.9	1.5	6.3	3.0	1.0	13.7	13.3	2.3
	Singapore	5	154	0.4	-4.5	-1.4	2.5	9.5	4.3	6.7	4.7	12.1	5.6	2.1	11.8	11.2	4.4
	Australia	23	826	2.0	-0.5	6.8	4.8	7.8	1.9	5.0	-1.3	7.0	-1.7	2.4	13.6	13.8	5.2
	South Korea	24	439	1.0	-1.7	-1.0	3.4	17.9	2.6	10.5	2.3	26.4	3.6	0.6	5.3	5.1	2.0
	Taiwan	14	430	1.0	1.5	-0.1	5.4	5.8	5.3	1.2	1.3	3.2	6.8	1.5	15.2	14.2	2.7
Emerging Markets	**Emerging Asia/Pacific**	**102**	**4,657**	**11.0**	**-0.2**	**3.0**	**8.4**	**20.0**	**7.1**	**11.2**	**9.1**	**13.7**	**12.1**	**1.8**	**12.6**	**11.3**	**2.7**
	China	19	1,998	4.7	-1.7	3.2	14.3	30.5	13.9	14.8	10.6	22.4	11.8	1.4	9.1	8.2	3.5
	Hong Kong	29	1,371	3.2	0.7	0.3	4.6	13.5	3.2	11.1	9.8	-6.1	11.3	2.8	17.5	15.7	2.2
	India	32	858	2.0	2.6	8.7	4.3	12.2	1.7	0.5	4.7	17.2	17.6	2.0	18.8	16.0	1.7
	Indonesia	7	163	0.4	2.2	-6.2	-10.0	-6.7	-13.2	3.5	7.2	7.8	11.5	3.5	17.8	16.0	2.9
	Malaysia	6	98	0.2	-6.1	-0.6	7.8	8.7	7.3	40.3	3.9	36.0	3.8	3.3	14.2	13.7	3.8
	Philippines	2	34	0.1	-5.9	1.5	-8.6	-0.4	-10.3	4.5	7.8	13.5	9.4	3.9	28.8	26.3	1.0
	Thailand	7	136	0.3	-2.4	-0.8	4.6	17.2	4.9	10.8	5.2	2.4	7.1	1.5	15.7	14.7	2.9
	Emerging Europe	**18**	**408**	**1.0**	**-4.4**	**-2.4**	**3.9**	**19.8**	**4.7**	**18.5**	**-4.4**	**34.6**	**-2.0**	**0.8**	**5.7**	**5.8**	**5.6**
	Czech Republic	1	12	0.0	-3.8	7.4	11.0	26.2	11.1	16.6	-0.4	-25.0	1.5	1.3	22.5	22.2	4.8
	Hungary	1	9	0.0	-9.0	-18.2	-7.7	4.0	-10.8	15.6	-0.6	0.7	-6.3	3.0	9.7	10.4	4.3
	Poland	4	36	0.1	-4.2	-3.4	-10.1	-4.3	-13.3	11.4	5.9	6.5	0.6	1.0	9.9	9.9	1.9
	Russia	11	345	0.8	-4.2	-2.0	5.7	23.3	7.5	19.5	-5.4	39.2	-2.0	0.7	5.3	5.4	6.1
	Turkey	1	6	0.0	-11.7	-34.3	-31.0	-37.5	-35.4	-9.6	-4.4	2.6	-5.0	1.5	4.2	4.4	3.7
	Emerging Americas	**25**	**799**	**1.3**	**-4.8**	**5.2**	**-5.0**	**-18.9**	**-3.0**	**8.2**	**-3.4**	**65.6**	**1.8**	**3.6**	**32.9**	**32.3**	**1.6**
	Brazil	14	362	0.9	-22.3	-24.9	-12.9	-2.1	-15.2	8.5	-4.9	89.1	0.9	1.1	8.6	8.5	4.4
	Chile	4	71	0.2	0.7	7.4	7.9	15.2	6.0	18.1	6.8	23.5	7.9	1.7	19.0	17.6	2.5
	Mexico	6	251	0.2	0.5	16.3	-5.1	-25.9	-1.4	5.0	-3.5	15.3	2.6	11.3	177.9	173.4	0.7
	Emerging Africa	**6**	**183**	**0.4**	**-8.3**	**-10.0**	**2.5**	**10.6**	**-7.5**	**12.6**	**3.9**	**30.7**	**16.9**	**3.8**	**17.3**	**14.8**	**2.4**
	South Africa	6	183	0.4	-8.3	-10.0	2.5	10.6	-7.5	12.6	3.9	30.7	16.9	3.8	17.3	14.8	2.4
	Sectors																
Global Sectors	Automobiles	35	1,201	2.8	0.8	5.0	3.0	13.8	2.9	8.3	1.2	17.0	4.8	0.6	9.8	9.4	2.9
	Banks	105	5,005	11.8	-4.6	-3.6	-0.8	6.8	-0.8	6.5	3.2	25.0	7.5	2.7	9.7	9.0	3.9
	Basic Resources	36	939	2.2	-2.4	7.3	11.3	31.0	5.9	14.3	-3.3	25.2	-5.1	1.0	11.3	11.9	3.9
	Chemicals	37	1,085	2.6	0.0	4.7	1.6	5.4	2.0	8.7	1.8	9.1	4.8	1.3	15.1	14.4	2.6
	Construction & Mat.	16	348	0.8	1.0	5.7	2.8	3.3	2.0	10.8	2.0	34.5	11.9	1.3	20.0	17.9	2.1
	Real Estate	44	963	2.3	2.0	6.0	2.5	5.7	3.3	17.9	14.0	-10.7	7.5	3.0	17.0	15.8	3.3
	Financial Services	39	1,097	2.6	0.2	3.0	5.0	14.5	5.9	-1.2	2.8	21.5	7.9	2.4	14.9	13.8	2.5
	Food & Beverage	44	2,034	4.8	2.9	1.8	-4.7	-5.6	-3.3	4.2	1.9	20.4	6.0	2.4	20.9	19.7	2.8
	Health Care	79	3,935	9.3	3.8	6.7	5.2	7.1	7.4	13.2	4.5	103.0	7.8	2.6	16.9	15.7	2.1
	Industrials	112	3,614	8.5	2.2	5.5	5.6	10.3	5.7	7.0	3.5	21.0	7.6	1.5	17.2	16.0	2.1
	Insurance	53	1,601	3.8	-1.6	-0.1	-1.3	5.0	-0.7	-11.5	3.3	7.0	8.5	0.9	10.7	9.8	3.4
	Media	22	2,056	4.9	3.7	15.8	4.1	-12.0	6.9	4.6	3.9	-22.9	10.1	5.9	47.7	43.4	0.8
	Energy	77	3,215	7.6	-3.6	14.2	11.3	16.0	9.4	18.7	-0.1	66.1	6.1	0.8	12.3	11.6	3.9
	Personal & HH Goods	47	1,968	4.6	3.2	8.5	4.1	5.6	5.7	7.1	3.7	-17.8	7.9	2.6	21.2	19.7	2.2
	Retail	42	2,706	6.4	6.7	12.8	17.3	30.4	18.8	8.1	5.7	21.1	14.0	1.0	28.3	24.9	1.2
	Technology	93	7,074	16.7	5.0	8.6	15.1	31.6	17.8	11.0	6.3	44.4	8.5	3.5	18.0	16.6	1.2
	Telecom	36	1,560	3.7	0.0	0.7	-5.5	-9.0	-4.6	3.1	-0.1	-12.0	5.1	1.3	13.0	12.3	4.9
	Travel & Leisure	31	832	2.0	3.8	7.3	5.3	8.8	7.4	6.5	4.6	10.4	4.9	1.7	15.4	14.7	1.7
	Utilities	52	1,100	2.6	0.5	4.4	-2.9	-4.7	0.8	7.9	-0.4	4.5	4.3	1.2	15.1	14.5	4.1
	World	**1000**	**42,333**	**100**	**1.5**	**6.2**	**5.8**	**11.0**	**6.8**	**7.8**	**2.7**	**24.0**	**7.0**	**1.7**	**15.3**	**14.3**	**2.5**

Source: FactSet, Erste Group Research Calculations.

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