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Russian bonds should see good performance

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Anton Hauser has been senior fund manager of ERSTE BOND DANUBIA for numerous years. The expert for Central and East European (CEE) government bonds has received several national and international awards. In this interview, he talks about the difficult first half of 2018 and illustrates possible future scenarios.

Anton Hauser, senior fund manager at Erste Asset Management and expert for Central and East European (CEE) government bonds

The CEE bond markets have come under significant pressure in recent months. What have been the crucial factors for this development?

The increase in bond yields (see table below) and the currency depreciation experienced by Central and Eastern Europe vis-à-vis the euro have been triggered by country-specific as well as geopolitical factors (e.g. rising commodity prices). The tighter monetary policy of the US central bank and the approaching end of the bond purchase programme of the European Central Bank has led to capital outflows from the emerging markets (and emerging markets funds). As a result, the pressure on CEE investments has increased. Also, a possible cut of transfer payments in the new EU budget has had a negative impact.

10Y yield of government bonds by comparison

(in %)

Source: Bloomberg, 20 July 2018
Note: Past performance is not indicative of future development.

How big is the risk of inflation becoming excessive in those countries?

The CEE countries are currently not running any significant macroeconomic imbalances. The increase in inflation – with the one in Turkey standing out at 15% (source: Bloomberg, 20 July 2018) – has been caused mainly by the rising oil price despite the substantial wage increases that we have seen. We do not expect core inflation to accelerate significantly in the region. Therefore, we only expect moderate interest rate increases and regard the most recent sell-off in the region as excessive.

You invest in the new EU member states as well as in bonds from Turkey and Russia. What sort of weighting do you keep, and how do you assess the foreseeable future of those countries?

Russian bonds in the fund are currently weighted at 13%, Turkish bonds at 14% (as of July 2018; source: Erste AM Fund Management).

The situation in **Russia** is largely stable. While debt levels are low, the high oil price supports economic growth. Due to the sanctions, the number of new issues is also very limited. Bonds falling due are reinvested in existing bonds. Given this scenario, the Russian economy should be developing relatively well in the coming months.

The situation in Turkey on the other hand is difficult. A massive current account deficit, high short-term liabilities, an overly loose monetary policy in connection with high political risk have caused a crisis of trust and put pressure on Turkish bonds and the currency. At the moment, there are hardly any signals to suggest what the economic policy might look like under the new presidential system. The most recent decision by the central bank, to refrain from hiking interest rates despite the high rate of inflation, came as a surprise and left many questions unanswered. The uncertainty on the Turkish capital market is accordingly high. That being said, as fund manager one cannot disregard the high yields of a currency that has already depreciated substantially. And lastly, I should like to point out that Turkey is experienced in handling high inflation and is well known for its unconventional monetary and fiscal policy.

Over the years, CEE bonds have repeatedly gone through phases of falling prices. Should the recent corrections be used to increase positions?

Falling prices lead to rising expected yields. Historically speaking, expected yields would be reflected quite well in actual yields. We believe that the situation this time will not be much different than previous ones.

Legal note:

Prognoses are no reliable indicator for future performance.

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