

IT CAME FROM THE EAST – VAMPIRES AND BOND VIGILANTES



Russell Clark's
Market Views

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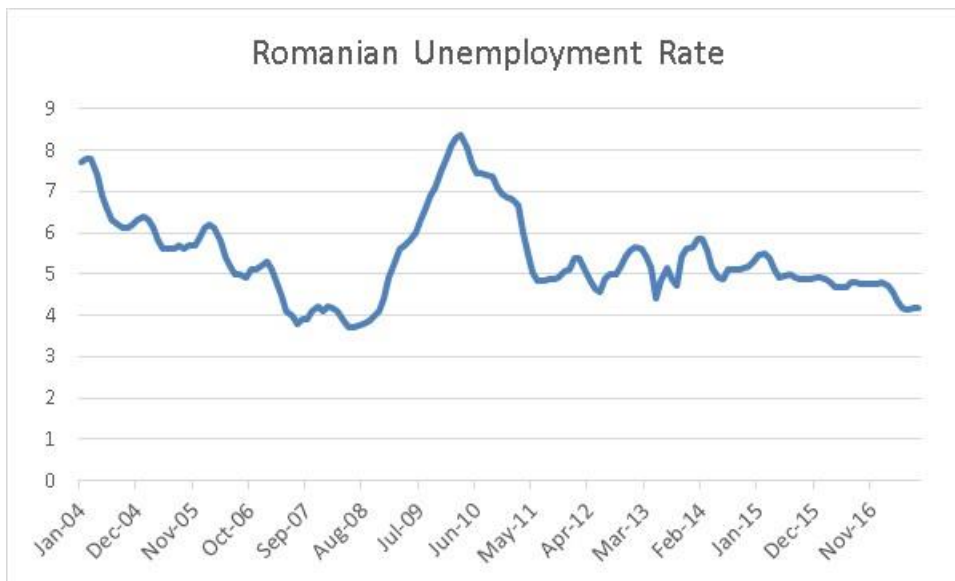
Bond vigilantes are much talked about in finance, but rarely seen in my experience. The last time we saw a prolonged bear market in government bonds was in the 1970s. Since then, bearishness on bonds has not been a rewarding trade. Many potential bond vigilantes have often looked to short Japanese bonds, which has proved to be a widower trade over the years.

However, for the first time in my investing career, I think I have started to see bond vigilantes achieving some success. The home of Count Dracula, the boy band Ozone, and Nadia Comaneci, could also be the first confirmed sighting of bond vigilantes in many years.

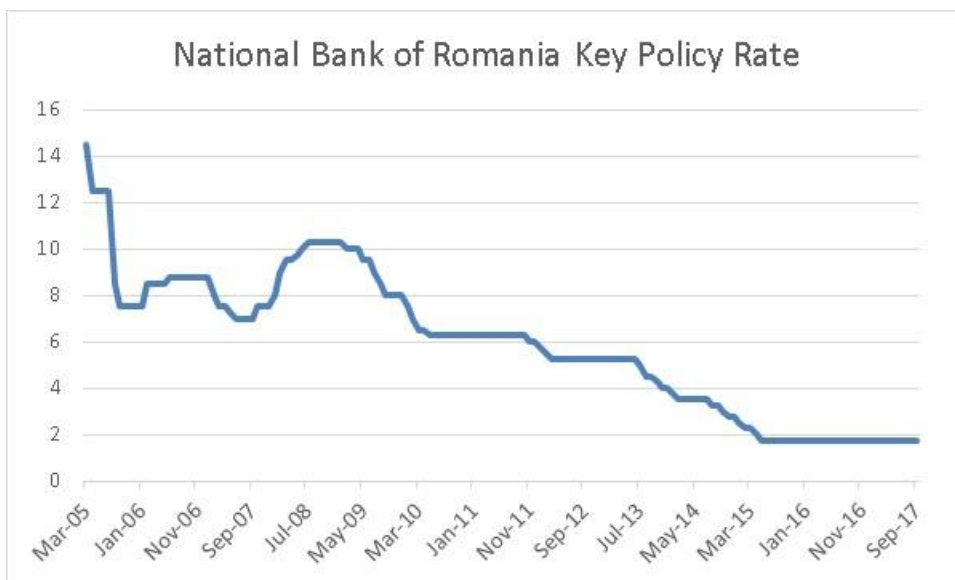
Pre- financial crisis, wages in Romania were growing at around 20% a year, and for many years post financial crisis, grew at only 5% but for the last two years have been growing at 15%.



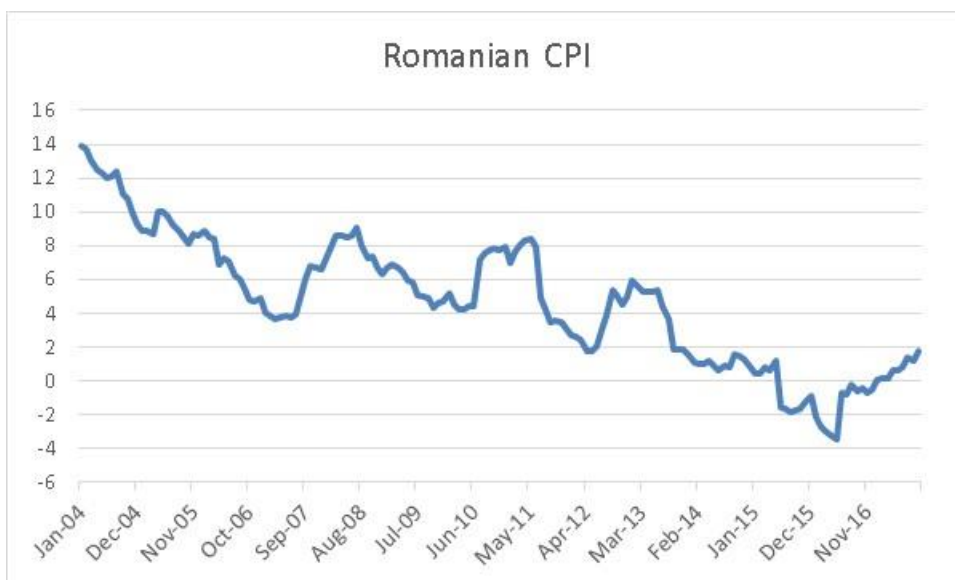
The increases in wages have been driven by the low unemployment.



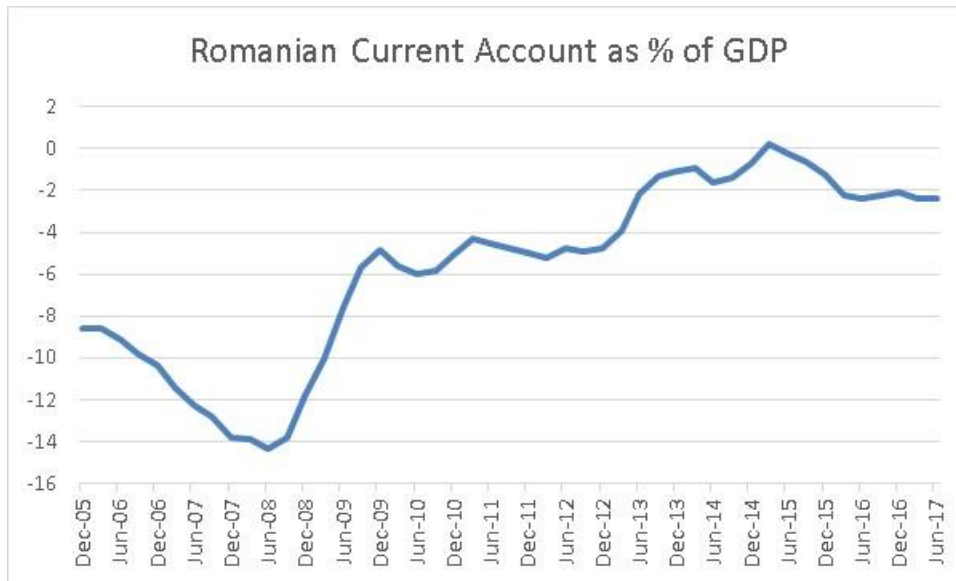
While Romania is part of the EU, it has not yet adopted the Euro but plans to in the future, possibly in 2020. Due to this, the National Bank of Romanian needs to follow European Central Bank interest rates closely.



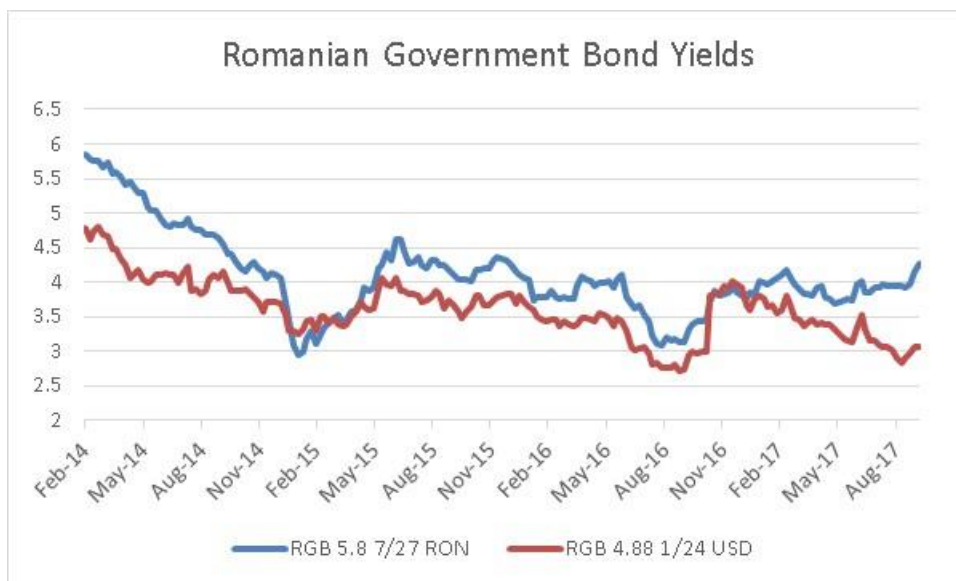
While wages have been growing strongly, it has been true that inflation in Romania has been subdued, mainly due to low commodity prices.



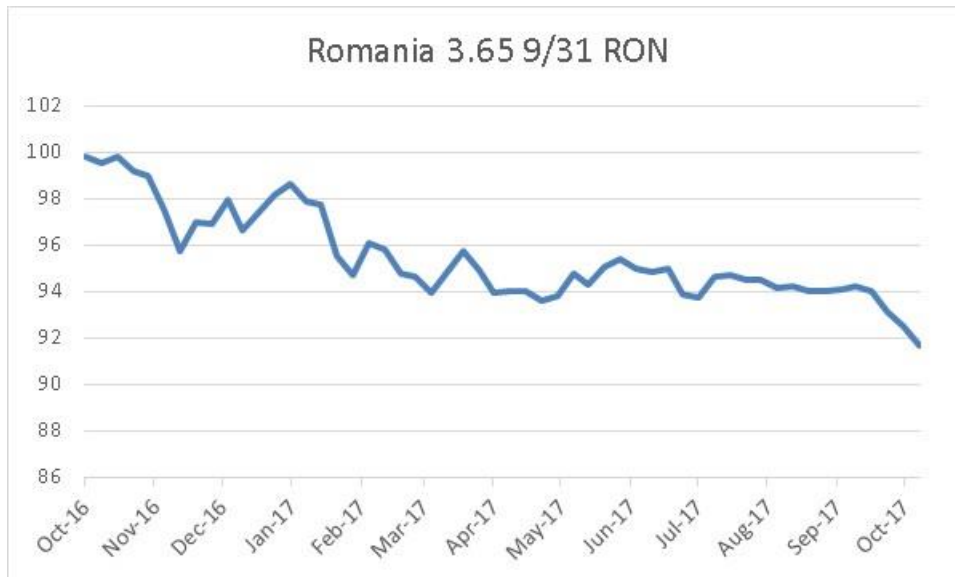
Despite strong wage growth, the Romanian current account is still in very good shape, currently running a deficit of 2% of GDP, compared to a near 16% deficit in 2007.



Given the relative low current account deficit and low inflation, the recent bloodbath in Romanian bonds seem to owe more to the market’s view on where interest rates should be, rather than any statement on currency or solvency risk. Intriguingly, dollar bond yield has remained low, while Romanian yields have risen to a high level, and the widest spread between dollar and local bonds for some years.



While the sell-off in yields looks contained, owners of the recently issued local currency bonds have been handed a near 10% loss. Similar bloodbaths have been seen at shorter tenors as well.



Perhaps Romanian local currency government bonds, which are not directly affected by Quantitative Easing (QE) in Europe or the US are truly able to reflect reflationary pressures? Bond vigilantes, long dormant, seem to be stirring from the crypt.

INFORMATION

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 Investor Relations: Alain Zakeossian, Samantha Dunn
 Email: info@horsemancapital.com
 Telephone: +44 (0)20 7838 7580
 Website: www.horsemancapital.com

Business and registered address: Horseman Capital Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

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