Aegon Asset Management

Asset Class Research
October 2023

AEGON **INSIGHTS**

Israel and emerging markets debt

Over the weekend, Hamas launched an attack on Israel which resulted in significant deaths, bombings and the escalation of tensions in the Middle East. For the emerging markets, relative to the scale of events in Israel, reaction has been fairly muted for most Middle Eastern and North African credits thus far.

Euart MacKerron, CFA
Research Analyst

Jeff Grills, CFA
Head of US Cross Markets and Emerging Markets Debt

As of Monday's close, Israel sovereign bonds were 25 to 35 basis points (bps) wider on spread, subordinated bank notes and energy bonds were 3 to 5 points lower. Within the Middle East, investment-grade bonds were 5 to 15 bps wider and high yield bonds were 0.5 to 1.5 points lower. Brent crude rose $4 a barrel and bund yields declined 11 bps. However, the latter also reflects relatively dovish monetary policy comments from central bank officials over the weekend.

The wider impact of recent events will depend on the nature and length of the conflict going forward. However, for Israel it is fair to expect there will be fiscal loosening, potential inflationary pressures from currency passthroughs—in the immediacy, the central bank has vowed to protect the currency from volatility—and some disruption to economic activity as reservists are called up from a tight labor market.

For corporates, the impact will likely vary. Israel's electric company declared a state of emergency following the incursion and was preparing to carry out any necessary grid repairs in the south. It is too early to estimate any asset damage, but it is likely limited given that the company is the monopoly transmission and distribution operator in the country and there are no reports of major power outages.

One Israeli chemical manufacturer has assets in areas close to the events, but so far says that activities continue to function. The firm could face some short-term disruption to fertilizer exports from the Port of Ashdod, north of Gaza. The impact on a banking sector, which enters this period with relatively sound fundamentals, will depend on how the economy responds. Should any weakness in loan quality or deposit flows become a material concern, we would expect the banks to be supported to maintain confidence.

The precautionary shut down of production at the Tamar gas field reflects 1). its processing platform being 25 kilometers west of Ashdod in relatively close proximity to the escalating conflict and 2). its export orientation being of a less critical nature to Israeli power supply.[1] Production at Leviathan and Karish is so far unaffected as their infrastructure is relatively distant from current events off Israel's northern coastline.[2] Karish's production is sold entirely to domestic power and industrial companies,

[1] "Chevron told by Israel to shut down Tamar gas platform," Seeking Alpha, October 9, 2023.
[2] "Israel's oil and gas sector," International Trade Administration, September 28, 2022.

accounting for approximately 50% of Israel's gas demand, which was reflected in the operator's statement that it "remains fully committed to underwriting the energy security of Israel during these challenging times."

The suspension of production from the Tamar gas field has potential ramifications for the country's main electric company, which sources the majority of its natural gas from Tamar.[3] The company will likely be able to replace its Tamar supply from a combination of gas from the Leviathan and Karish fields (which together produce enough gas to meet domestic demand), liquid natural gas (LNG) and alternative sources such as fuel oil and coal. In a more adverse scenario, where production from other gas fields could be impacted due to their vulnerability as critical infrastructure targets in an escalated conflict or due to a prolonged period of pressure from switching fuel supplies, it is anticipated that the Israeli government would provide support to the company, similar to their actions during the energy disruption of the Arab Spring.

Beyond Israel, Egypt is perhaps most at risk from escalation in the conflict, not just from the potential cost of a refugee crisis at its border but also from a disruption in Israeli gas supplies. Amid severe balance of payments pressures in recent years, 2022's record gas export revenues of $8.4 billion were a welcome reprieve. Israel, as its natural gas production has ramped up and without its own LNG processing infrastructure, has increasingly exported surplus production from Tamar and Leviathan to Egypt's LNG terminals. Although there are currently no reports of disruption to export pipelines, in the event that there is a prolonged disruption to these activities, such that Egypt moves into a gas deficit, it would add to already prevalent financial and inflationary pressures in the country.

Additional spread premium will now be warranted across the Gulf due to the risk of the conflict becoming more regional, but absent an escalation such that the conflict moves beyond Israel's borders, emerging market debt is likely to treat the conflict as a relatively localized event. Neither Israel or its immediate neighbors are significant commodity exporters—unlike the challenges posed by Russia and Ukraine's meaningful contributions to global energy and agriculture commodity flows. As far as broader Middle East implications, most of the region is already investment grade and the impact to asset pricing should be fairly muted, as it has been already. Given allegiances, eyes will refocus on potential disruption to Iran's oil flows, which are near a five-year high. Yet as we have seen with the reorientation of Russia's oil exports, imposing a more punitive sanctions regime on purchases of Iranian crude—and disrupting global oil markets—would likely prove difficult due to buyers being primarily outside the G7's sphere of influence.

Beyond Israel, Egypt is perhaps most at risk from escalation in the conflict, not just from the potential cost of a refugee crisis at its border but also from a disruption in Israeli gas supplies.

[3]"Israel orders Chevron to shut down production at major natural gas field located off southern coast," CNN, October 9, 2023.

Disclosures

This material is provided by Aegon Asset Management (Aegon AM) as general information and is intended exclusively for institutional and wholesale investors, as well as professional clients (as defined by local laws and regulation) and other Aegon AM stakeholders.

This document is for informational purposes only in connection with the marketing and advertising of products and services, and is not investment research, advice or a recommendation. It shall not constitute an offer to sell or the solicitation to buy any investment nor shall any offer of products or services be made to any person in any jurisdiction where unlawful or unauthorized. Any opinions, estimates, or forecasts expressed are the current views of the author(s) at the time of publication and are subject to change without notice. The research taken into account in this document may or may not have been used for or be consistent with all Aegon AM investment strategies. References to securities, asset classes and financial markets are included for illustrative purposes only and should not be relied upon to assist or inform the making of any investment decisions. It has not been prepared in accordance with any legal requirements designed to promote the independence of investment research, and may have been acted upon by Aegon AM and Aegon AM staff for their own purposes.

The information contained in this material does not take into account any investor's investment objectives, particular needs, or financial situation. It should not be considered a comprehensive statement on any matter and should not be relied upon as such. Nothing in this material constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to any particular investor. Reliance upon information in this material is at the sole discretion of the recipient. Investors should consult their investment professional prior to making an investment decision. Aegon Asset Management is under no obligation, expressed or implied, to update the information contained herein. Neither Aegon Asset Management nor any of its affiliated entities are undertaking to provide impartial investment advice or give advice in a fiduciary capacity for purposes of any applicable US federal or state law or regulation. By receiving this communication, you agree with the intended purpose described above.

Past performance is not a guide to future performance. All investments contain risk and may lose value. This document contains "forward-looking statements" which are based on Aegon AM's beliefs, as well as on a number of assumptions concerning future events, based on information currently available. These statements involve certain risks, uncertainties and assumptions which are difficult to predict. Consequently, such statements cannot be guarantees of future performance, and actual outcomes and returns may differ materially from statements set forth herein.

The following Aegon affiliates are collectively referred to herein as Aegon Asset Management: Aegon USA Investment Management, LLC (Aegon AM US), Aegon USA Realty Advisors, LLC (Aegon RA), Aegon Asset Management UK plc (Aegon AM UK), and Aegon Investment Management B.V. (Aegon AM NL). Each of these Aegon Asset Management entities is a wholly owned subsidiary of Aegon Ltd. In addition, Aegon Private Fund Management (Shanghai) Co., a partially owned affiliate, may also conduct certain business activities under the Aegon Asset Management brand.

Aegon AM UK is authorised and regulated by the Financial Conduct Authority (FRN: 144267) and is additionally a registered investment adviser with the United States (US) Securities and Exchange Commission (SEC). Aegon AM US and Aegon RA are both US SEC registered investment advisers.

Aegon AM NL is registered with the Netherlands Authority for the Financial Markets as a licensed fund management company and on the basis of its fund management license is also authorized to provide individual portfolio management and advisory services in certain jurisdictions. Aegon AM NL has also entered into a participating affiliate arrangement with Aegon AM US. Aegon Private Fund Management (Shanghai) Co., Ltd is regulated by the China Securities Regulator Commission (CSRC) and the Asset Management Association of China (AMAC) for Qualified Investors only;

AdTrax: 6012919.1GBL