Manulife Investment Management

Investment Note

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The steep decline in oil prices during the week of 9 March 2020 sent global markets sharply lower. However, Asia may emerge as a principal beneficiary of this trend, as many countries in the region are net oil importers. In this investment note, Endre Pedersen, Chief Investment Officer, Fixed Income, Asia (ex-Japan), explains why Asian fixed income may be well placed to withstand short-term market volatility and how to capture long-term opportunities for investors.

Identifying the winners and losers of oil price slump: the Asian fixed income perspective

Asia: Some countries poised to benefit from lower oil prices

The recent sharp decline in oil prices, coupled with the ongoing risk-off market environment, introduced additional volatility and uncertainty to global and Asian financial markets.

During periods of heightened volatility, investors are unlikely to appreciate the contrast between the region's "winners" and "losers" that come from lower oil prices. For example, on 9 March, the Korean won, and Indian rupee both weakened against the US dollar, despite South Korea and India being beneficiaries of oil-price weakness.

Similarly, Asian credits lack differentiation at this juncture, as most Asian credit spreads widened given the already thin market liquidity conditions. We believe that some of these dislocations are driven more by market sentiment than fundamentals.

In our view, the following markets will benefit or be hurt by lower oil prices.

Winners:

- China, India, the Philippines, and South Korea, as net importers of oil, are expected to benefit from a weaker oil price. Lower energy costs, which lead to improved trade balances, should be supportive of these countries' currencies on a relative basis. Moderating oil prices also have a disinflationary impact and may result in generally lower Asian bond yields, given reduced expectations for higher inflation in the future. India stands out in this group as a primary beneficiary (having experienced rising inflation from food prices recently). As concerns about price increase ease, the Reserve Bank of India will have more room to resume monetary-policy easing.

Losers:

- Malaysia is a net exporter of refined fuel. The country's government may need to revise its budget due to lower oil prices. This may subsequently have a negative impact on the Malaysian ringgit in the near term. That said, the diminished oil price puts additional pressure on Bank Negara Malaysia to cut interest rates to support the economy, which is positive for lower local yields.

- Indonesia is a net exporter of natural resources. However, we expect its economy to benefit less from lower energy prices than other markets given that the country has a domestic-driven economy (it exports around 20% of GDP). We subsequently believe a more constructive view towards Indonesia relative to other Asian economies will prove compelling in the long run.

Market Outlook

Once markets stabilise, the sharp fall in US Treasury yields and increased Asian yield premiums (versus developed-market bonds) should be broadly supportive for Asian hard- and local-currency bonds. Notably, the currencies of Asia’s net energy importers should outperform on a relative basis. In the medium term, with US Treasury yields lower and the spread of COVID-19 largely contained in Asia, liquidity conditions should normalise, and this will help to recover some of these price dislocations.

Furthermore, we think that high-quality Asian investment-grade (IG) credits, including most government-backed oil names, will continue to see strong support. However, gaming and commodity issuers in the private sector may face headwinds. Investors should be more selective in credit screening for these sectors.

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