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Investment Strategy & Research

GCC Fixed Income Market Update

December-2022

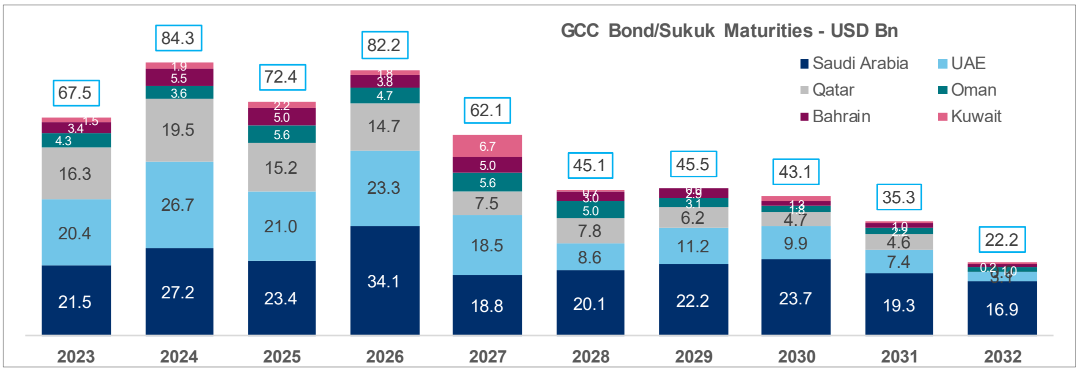
GCC FI issuances drop 41% in 2022; expect 2023 to be 2H loaded...

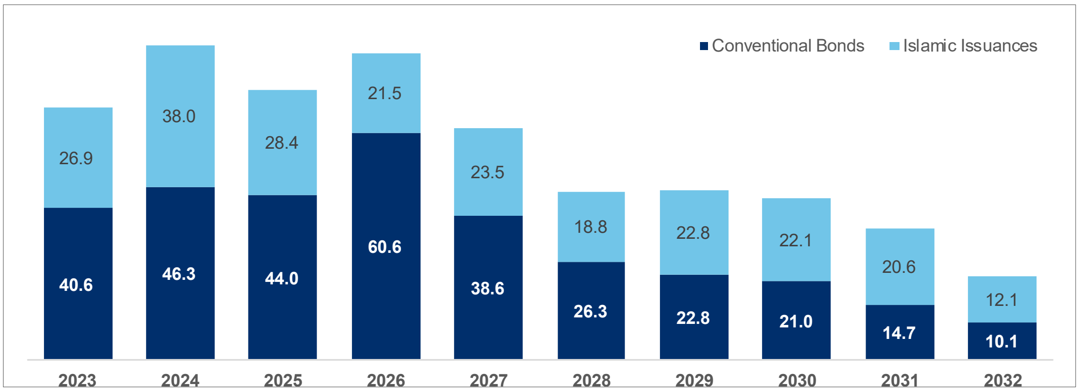
Fixed income issuances in the GCC witnessed a steep decline during YTD-2022 led by lower issuances from both sovereigns and corporates. The decline in govt. issuances mainly reflected higher oil prices that lowered the funding requirements. On the corporate side, the decline was led by rising interest rates as well as high equity valuations that made raising funds from the equity markets more enticing vs. the bond market.

On the economic front, GCC governments are expected to record one of the highest annual GDP growth rates this year led by thriving economic activity post the pandemic, in addition to elevated government spending in the project market. ***According to consensus estimates, GCC economies are expected to clock a GDP growth rate of 7.3% in 2022 as compared to 2.5% in 2021. Growth in 2023 and 2024 are expected to be relatively smaller at 3.4% and 2.9%, respectively. The pace of economic activity was also reflected in the PMI figures for the region that stayed comfortably above the 50 mark for Saudi Arabia, Qatar, UAE and Dubai since the start of the year.***

On the global front, much of the expectations during the year were swayed by when and how China reopens its economy from its Zero-covid policy. And after the recent lifting of restrictions, the debate now is whether the country will go back to lockdowns with several reports showing spiking cases and overloaded medical facilities. ***Growth in the rest of the world economies was affected by higher commodity prices, including crude oil prices, due to the supply impact from the Russia/Ukraine conflict. The record high energy/utility prices further exacerbated the inflation problem that had reached record high levels during the year mainly due to the lose monetary policy adopted during the pandemic which also led to record high debt levels for several economies.***

To fight the persistent inflation, the US Fed raised policy rates at one of the fastest rates on record by 425 bps points this year and the message in the latest statement was hawkish indicating further rate hikes in 2023. Global central banks also followed with rate hikes. *The extraordinary increase in interest rates was reflected a steep decline in negative yield bonds with the ECB and other European countries along with Japan doing away with their negative-rate policy.* ***Central banks in the GCC also largely followed the US Fed in raising policy interest rates in order to maintain currency pegs.***





Sources : Bloomberg, Kamco Invest Research. Note: All data as of 21-Dec-2022, including YTD-2022 issuances.

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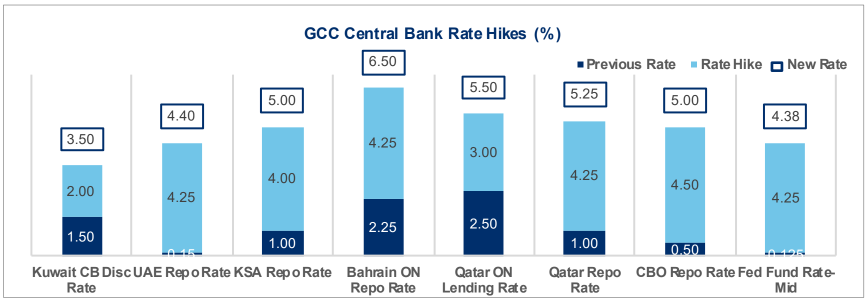
Rating actions and interest rates

Sovereign rating actions since the start of 2022 were mainly focused on European sovereigns during the first half of the year mainly led by the Russia/Ukraine war but the second half rating changes mainly for African economies as well as other developing and emerging economies. Total rating actions were almost equally split between upgrades and downgrades. According to data from Bloomberg, this year almost 25 sovereign rating downgrade and upgrade rating actions were taken by the rating agencies.



GCC - Sovereign Credit Ratings Profile

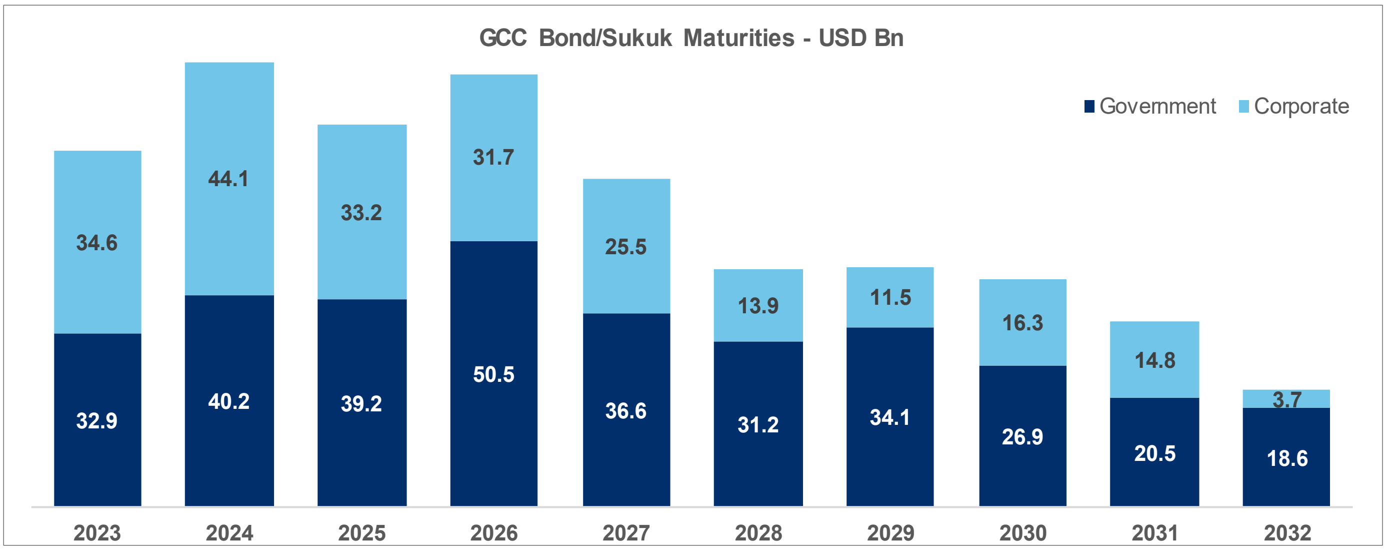
	S&P		Moody's		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Bahrain	B+	POS	B2u	STABLE	B+	STABLE
Kuwait	A+	STABLE	A1	STABLE	AA-	STABLE
Oman	BB	STABLE	Ba3	POS	BB	STABLE
Qatar	AA	STABLE	Aa3	POS	AA-	STABLE
Saudi Arabia	A-u	POS	A1	STABLE	A	POS
UAE	NR	NR	Aa2	STABLE	AA-	STABLE
Abu Dhabi	AA	STABLE	Aa2	STABLE	AA	STABLE

Sources : Bloomberg, Kamco Invest Research

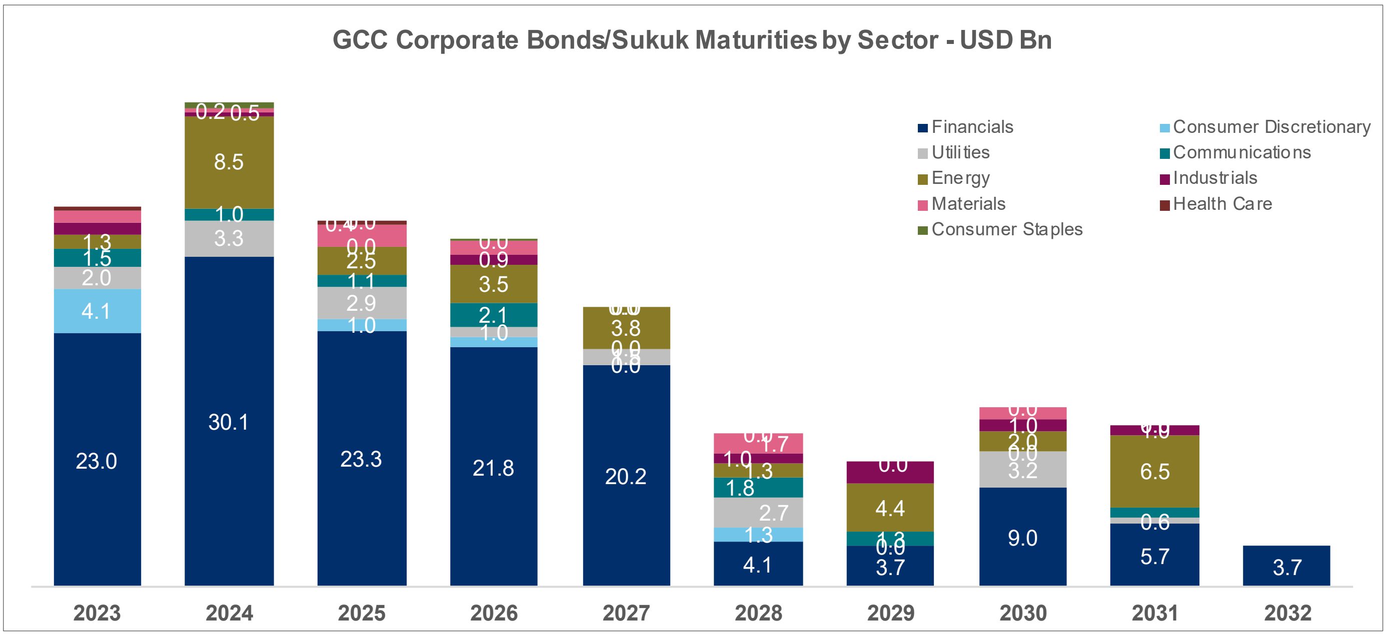
Outlook for 2023 shows rating actions skewed to the downside as higher interest rates test vulnerable countries' ability to raise and service debt. This was echoed in a recent World Bank report which showed a significant increase in debt vulnerabilities facing low and medium income countries. The report added that rising interest rates and slowing global growth risks pushing a number of countries in a debt crisis. The downside risks mentioned above also indicates that investors are expected to prefer a flight to safely towards high-grade debt next year. This compares to the outperformance in the high-yield bond secondary market (junk bonds) this year vs. investment grade bonds. Emphirical data, as suggested by a Bloomberg report, also showed investment grade returns mostly beat junk bond returns when the economy slows down.

Meanwhile, the latest consensus estimates suggest a 65% probability of a recession in the US in 2023 with annual GDP growth falling down to 0.3% from 1.9% expected in 2022. Inflation is also expected to remain elevated, but halve from the decades high level of around 8.0% to 4.0% in 2023. The elevated inflation resulted in interest rate hikes during the year aggregating around 425 bps to reach a mid-point of 4.38%. The forecast from US Fed shows further 75 bps hikes in 2023 that would push the median rate to 5.1%, higher than consensus expectations and indicating rate cuts only beginning from 2024.

Sovereign rating actions in the GCC favored positive actions with two upgrades during the year as against one downgrade. Oman's sovereign rating witnessed two upgrades this year by S&P from B+ to BB- in April-2022 followed by another upgrade to BB in November-2022 with a Stable outlook. Fitch also upgraded Oman's sovereign rating to BB from BB– during August-2022. The upgrade reflected higher oil prices that was reflected in Oman's fiscal metrics and the government's ongoing fiscal reform program. The sovereign rating for Qatar was also upgraded from AA- to AA by S&P during November-2022. The upgrade reflected the government's fiscal position resulting from higher oil revenues as well as lower interest costs as the government is repaying maturing debt. Kuwait, on the other hand, was downgraded one notch by Fitch to AA- in January-2022 reflecting structural challenges and dependence on oil.



Sources : Bloomberg, Kamco Invest Research



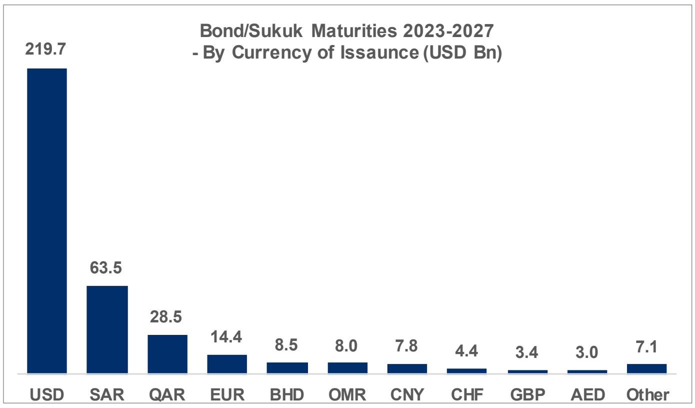
Sources : Bloomberg, Kamco Invest Research

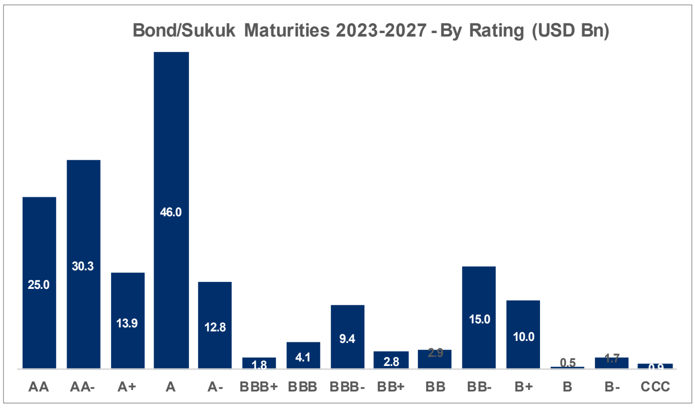
Bond/Sukuk Maturities

GCC governments are expected to see USD 199.3 Bn in fixed income maturities over the next five years (2023-2027), whereas corporate maturities stand slightly lower at USD 169.1 Bn. Both bond and sukuk maturities are expected to remain elevated starting from 2023 until 2027 and then gradually taper for the rest of the tenor. The higher maturities during the next five years reflects a number of short-term (less than 5-year maturity) issuances in 2020 and 2021 as governments raised funds to plug-in deficits during the pandemic. A majority of these maturities are denominated in USD at 59.7% followed by local currency issuances in SAR and QAR at 17.2% and 7.7%, respectively. In addition, due to the credit rating profile of the GCC governments, a majority of these maturities are in the high investment grade or A rated instruments. In terms of type of instruments, conventional bonds dominate with USD 230.1 Bn in maturities over the next five years, whereas sukuk maturities are expected to be at USD 138.3 Bn. In terms of country split, Saudi Arabia has overtaken UAE in terms of biggest maturities over the next five years. The Kingdom is expected to see maturities of USD 125.0 Bn until 2027 followed by UAE and Qatari issuers at USD 109.8 Bn and USD 73.1 Bn, respectively.

In terms of sector maturities, Banks and other Financial Services sector have USD 118.4 Bn in maturities in the next five years, accounting for around 70.0% of the total corporate maturities and 32.1% of the total maturities in the GCC until 2027. The Energy sector was next with maturities of USD 19.6 Bn or 11.6% of GCC corporate maturities until 2027 followed by Utilities and Consumer Discretionary at USD 10.7 Bn and USD 6.0 Bn, respectively. Banks in UAE have the biggest maturities over the next five years at USD 49.7 Bn followed by Qatari banks with maturities of USD 27.0 Bn. Banks in the two countries accounted for 20.8% of total bond/sukuk maturities over the next five years in the GCC. Real Estate maturities are concentrated mainly in the UAE and Saudi Arabia at USD 5.5 Bn and USD 3.5 Bn, respectively, until 2027.

The structure of maturities are also changing gradually as an increasing number of issuances are perpetual instruments. According to data from Bloomberg, perpetual issuances saw growth for the eight consecutive year in 2022. Issuances reached USD the highest on record for the GCC at USD 11.4 Bn during 2022 as compared to USD 9.6 Bn in perpetual instrument issuances in 2021.





Sources : Bloomberg, Kamco Invest Research

Outlook

For 2023, we expect that tighter monetary policies globally would limit overall issuances that would be further dampened by global recessionary pressures. The trend in inflation would remain key to stability in the bond market as it would decide the path that central banks take to manage economic expectations. That said, economic growth in the GCC region is expected to beat global growth with project market activity expected to pick up from a slowdown over the last few quarters. This is expected to support fixed income issuances in the GCC.

GCC bonds and sukuk maturities are expected at USD 67.5 Bn for 2023 and the refinancing of these instruments are expected to account for the bulk of the issuances by corporates and governments in the region. That said, the higher cost of borrowing and strong profitability coupled with cash generation is expected to discourage some refinancing activity in the near term. We expect fresh issuances to be back-end loaded once stability is seen in global interest rates and exchange rates. We expect corporate issuers to come back to market during the latter half of the year once market conditions seem favorable. Sovereigns in the GCC are expected to report fiscal surpluses due to elevated oil prices. This is expected to limit overall issuances, although with diversification as a primary goal for most governments, we can expect to see project-specific issuances during the year. Moreover, sovereigns in the region still require funding in the medium- to long-term to meet their long-term strategic visions. We expect overall fixed income issuance to remain flat in 2023 or show a small growth to range between USD 80-USD 85 Bn reflecting the aforementioned factors.

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