GCC Fixed Income Market Update

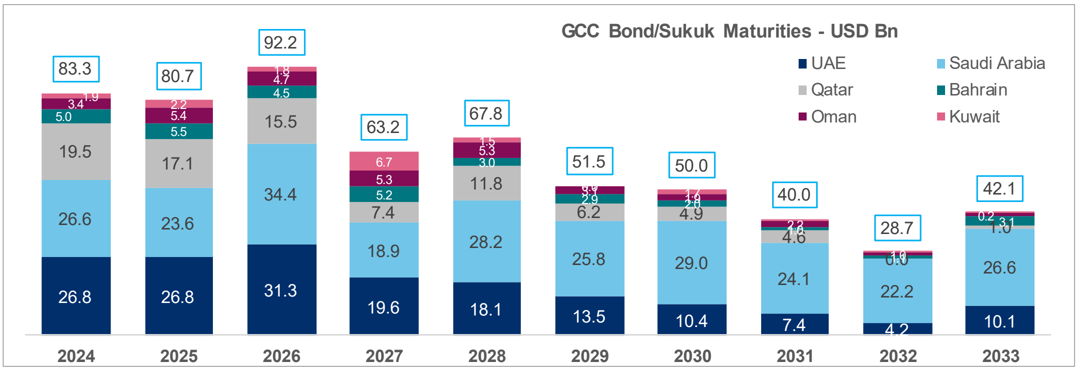
December-2023

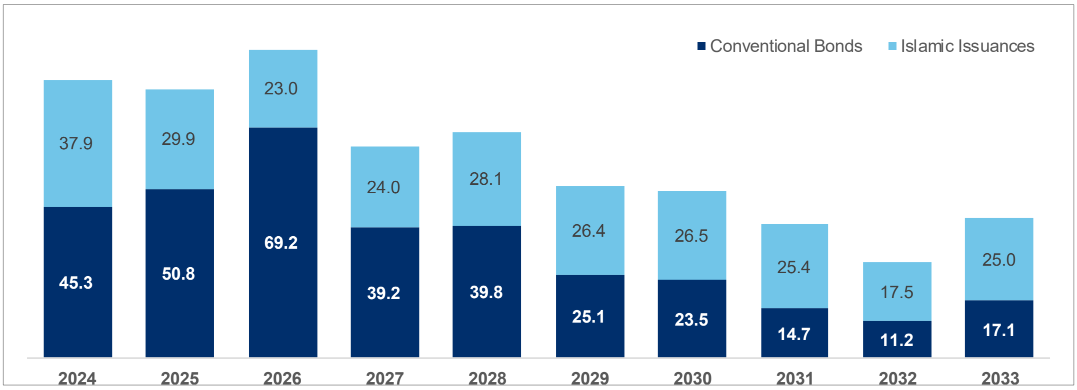
Bond market rallies on aggressive rate cut expectations...

Global bonds and government securities witnessed gains recently backed by a faster-than-expected rate cut expectations, although a number of economists said that the market is being overly optimistic. Traders are now pricing in disinflationary pressure over the next few months resulting in an accelerated rate cut approach. *This was reflected in yield on treasury bonds that swung from a 16-year high to multi-month lows. Yield on US 10-year treasury bonds declined from 5.02% in October-2023 to around 4.3% by the third week of December-2023. The yield on Bund and gilts also dropped to multi-month lows reflecting latest data on inflation that came in lower than market expectations. Swap traders priced in almost six 25 bps cuts next year, that many believed to be overly aggressive. Cuts from ECB were even more steeper, with traders pricing in 162 bps decline next year led by softer economic data and slowing inflation. Market is now expecting ECB to be the first to implement rate cuts next year, although the ECB vehemently denied the forecast in a recent statement. The EU is also implementing new rules on the fiscal front related to breaches to budget deficits and debt-to-GDP ratio in order to realign policies more in line with new economic realities.*

The impact on GCC economies is expected to be largely positive as global economic slowdown in now expected to be softer-than-expected, with soft landing in economic growth. This coupled with lower inflation rates in the GCC should augur well for the region in terms of GDP growth backed by thriving non-oil GDP, a strong project pipeline and elevated oil price above the USD 70/b mark. *In addition, the strong credit profile of most countries in the GCC with recent upgrades this year also provides stability to currency and the fixed income funding market.*

In the primary market, GCC bonds and sukuk issuances exceeded our and market expectations with several big-ticket issuances during the second half of the year. Sukuk issuances in Saudi Arabia coupled with bond issuances in the UAE during 2H-2023 pushed aggregate issuances in the GCC to over USD 100 Bn at USD 107.8 Bn by mid-December-2023. This compares with USD 90.0 Bn in total bond and sukuk issuances in the GCC during full year 2022. However, despite the growth, issuances in the GCC remained well below the issuances seen during the preceding five years (2017-2022) that averaged at USD 136.2 Bn.





Sources : Bloomberg, Kamco Invest Research. Note: All data as of 19-Jun-2023, including YTD-2023 issuances.

Junaid Ansari
Head of Investment Strategy & Research
+(965) 2233 6912
jansari@kamcoinvest.com

Inflation and interest rate hikes

The slowing inflation seen over the last few months have drastically altered investor and trader's expectation for the fixed income market. The last meeting of the year was instrumental in changing the rate cut/pause forecasts for 2024. From a scattered expectation of one or two hikes in 2024 during the later half of 2024 just a few months ago, the consensus forecast now shows at least 150 bps cuts during 2024. Some economists also see earlier rate cuts in the US as against 2H-2024 cuts as per previous expectations.

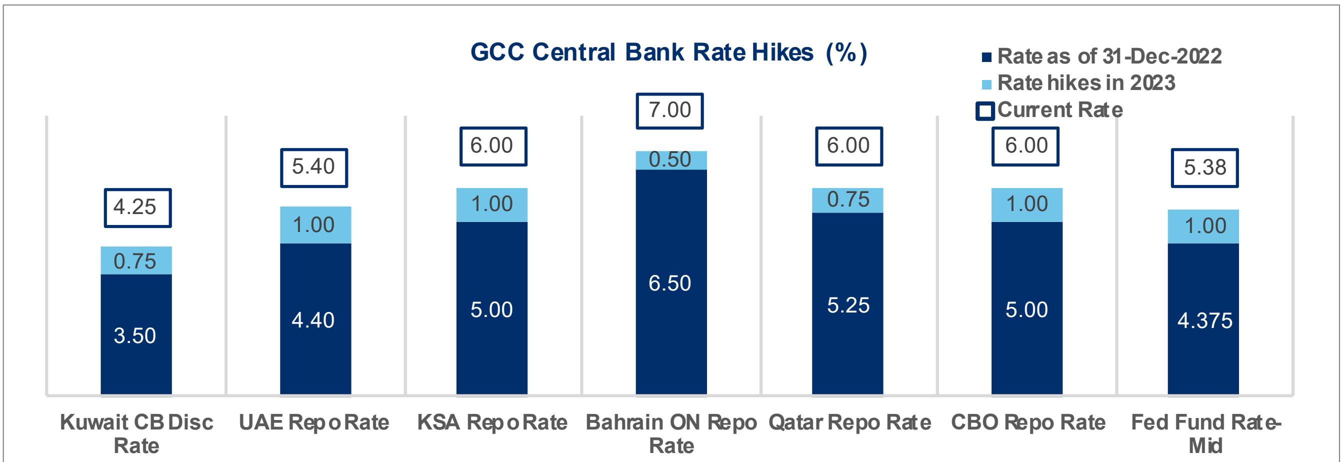
In its most recent meeting, the US Fed kept the rates unchanged in the range of 5.25% - 5.5% after consistent hikes until July-2023. The rate pause was expected by the market as inflation is seen cooling in the near term and economic growth is expected to remain subdued. The most recent reading of headline inflation came in at 3.1% y-o-y growth during November-2023 after showing a gradual decline since the start of the year. Excluding volatile food and energy prices, the core CPI increased 0.3% as compared to the previous month and 4% y-o-y. Prices for a broad range of goods and services were higher in November-2023, but were in line with expectations. In terms of forecast, The US Fed expects inflation to fall to 2.4% in 2024, lower than its previous forecast of 2.6%. The Fed forecasted core personal consumption expenditures price index to decline to 2.2% by 2025 (2.3% expected previously) and finally reach its 2.0% target in 2026.

Rates hikes by the ECB also took a pause after 10 consecutive rate hikes until September-2022. The bank raised its rate for refinancing operations to a record 4.5% and deposit rate also to a record 4.0% in September-2023 after the most aggressive tightening of monetary policy in the ECB's 25-year existence. The uncertainty related to economic growth and inflation trend was significantly high at the time of the rate hike and as a result analysts and traders were expecting a rate cut only during the third quarter of 2024 at the earliest. However, after a steep fall in inflation that dropped to 2.4% last month from 10% a year earlier put the EU's 2% inflation target in sight and proved the group's earlier forecast which said that inflation would remain stubborn for the next two years. Even the most influential and hawkish policymakers in the EU changed their stance to an earlier and steeper rate cut next year.

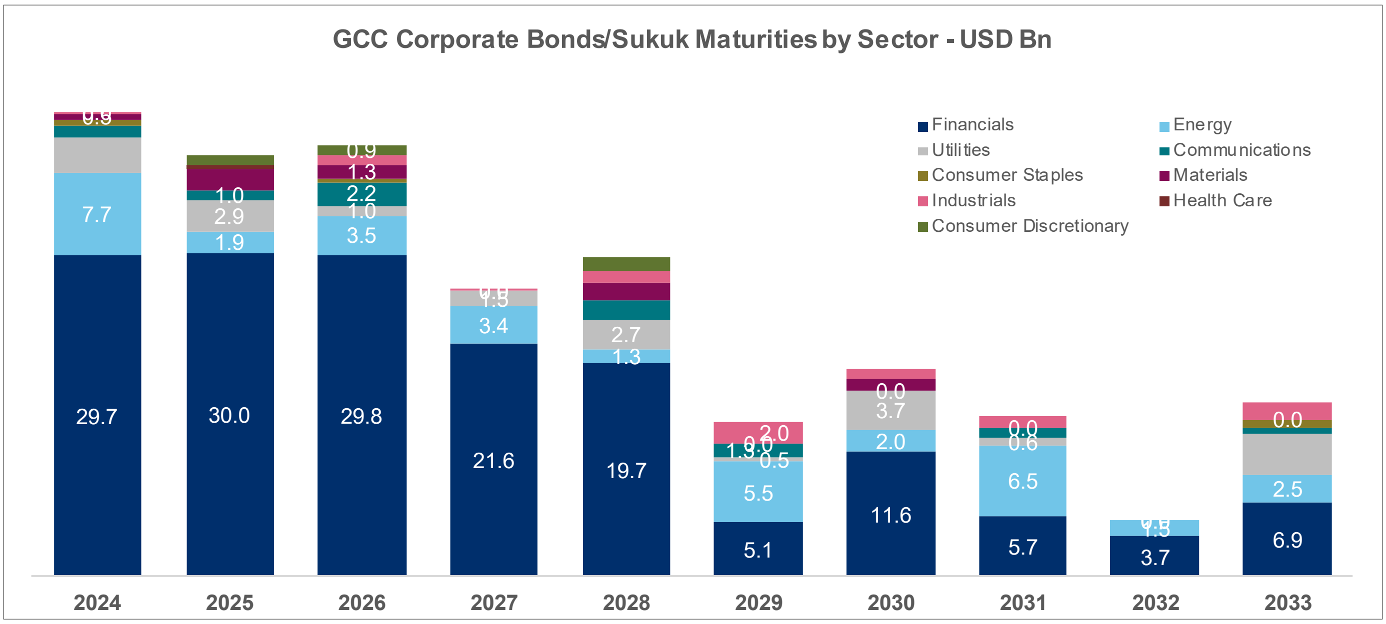
GCC - Sovereign Credit Ratings Profile

	S&P		Moody's		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Bahrain	B+	STABLE	B2	STABLE	B+	STABLE
Kuwait	A+	STABLE	A1	STABLE	AA-	STABLE
Oman	BB+	STABLE	Ba2	NR	BB+	STABLE
Qatar	AA	STABLE	Aa3	POS	AA-	POS
Saudi Arabia	A	STABLE	A1	POS	A+	STABLE
UAE	NR	NR	Aa2	STABLE	AA-	STABLE
Abu Dhabi	AA	STABLE	Aa2	STABLE	AA	STABLE

Meanwhile, in the GCC, economic growth was revised lower after the decision by the OPEC+ to slash oil productions until next year and added voluntary cuts until the first quarter of 2024. Crude oil prices also provided volatility to forecasts after a wild swing in prices that reached multi-month lows during the second half of the year. Nevertheless, inflation in the region remained under control as a result of proactive policies of the regional governments and mostly trended lower over the last few month. The trend in interest rates in the GCC was almost in line with that by the US Fed. Most GCC central banks raised rates by 100 bps while some implemented lower rate hikes depending on the existing rates and the pressure on the currency pegs. The rating actions in the GCC were largely positive during this year with most upgrades to Oman after the country successfully steered the economy from deficits to a much more manageable finances, including earlier than maturity repayment of debt. The sultanate was upgraded by all the three ratings agencies and the most recent upgrade from Moody's cited improvement in debt affordability matrix as the rationale for the upgrade.



Sources : Bloomberg, Kamco Invest Research

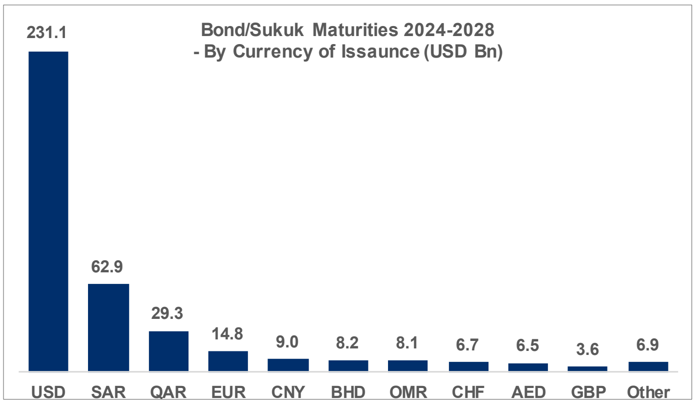


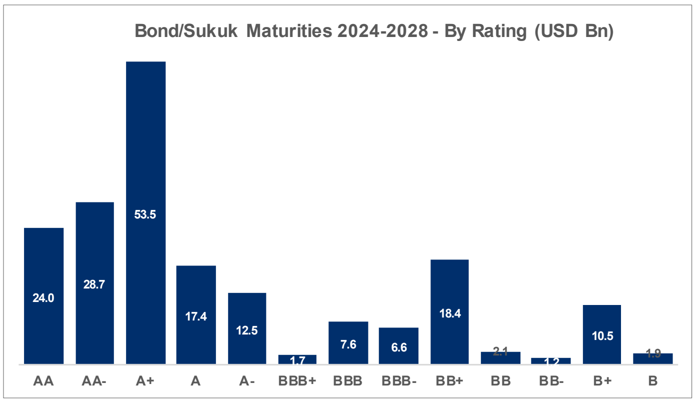
Sources : Bloomberg, Kamco Invest Research

Bond/Sukuk Maturities

GCC governments are expected to see elevated levels of maturities over the next five years. According to data from Bloomberg, GCC sovereign maturities stands at USD 209.3 Bn over the next five years (2024-2028), whereas corporate maturities stand significantly lower at USD 177.9 Bn. Both bond and sukuk maturities are expected to remain elevated starting from 2024 until 2028 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 16.3% and 7.6%, 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 244.3 Bn in maturities over the next five years, whereas sukuk maturities are expected to be at USD 142.9 Bn. In terms of country split, Saudi Arabia continues to see the biggest maturities during 2024-2028. The Kingdom is expected to see maturities of USD 131.9 Bn until 2028 followed by UAE and Qatari issuers at USD 122.5 Bn and USD 71.4 Bn, respectively. Kuwait has the smallest maturities in five years at USD 14.1 Bn due to lack of government issuances.

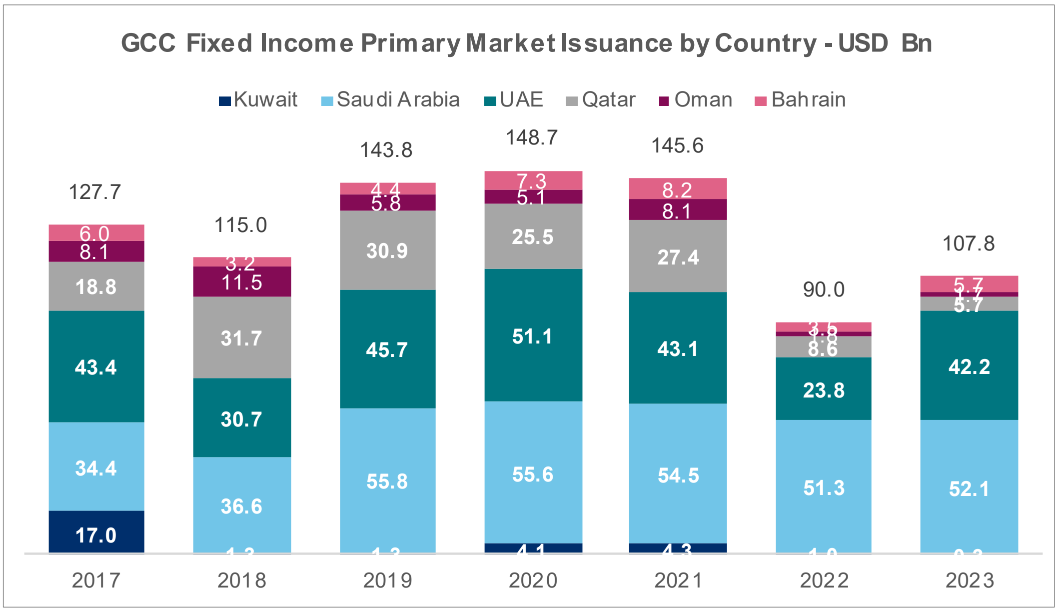
In terms of sector maturities, Banks and other Financial Services sector have USD 130.9 Bn in maturities in the next five years, accounting for around 73.6% of the total corporate maturities and 33.8% of the total maturities in the GCC until 2028, respectively. The Energy sector was next with maturities of USD 17.9 Bn or 10.0% of GCC corporate maturities until 2028 followed by Utilities and Communications at USD 11.4 Bn and USD 6.1 Bn, respectively. Banks in UAE have the biggest maturities over the next five years at USD 60.2 Bn followed by Qatari banks with maturities of USD 26.3 Bn. Banks in the two countries accounted for 22.3% 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 6.3 Bn and USD 2.9 Bn, respectively, until 2028. The structure of maturities saw perpetual instruments seeing consistent growth until 2022. However, 2023 witnessed a steep decline in issuances of perpetual instruments. According to data from Bloomberg, aggregate issuances declined from USD 11.5 Bn in 2023 to merely USD 2.0 Bn during 2023.





Sources : Bloomberg, Kamco Invest Research

Issuances in 2023

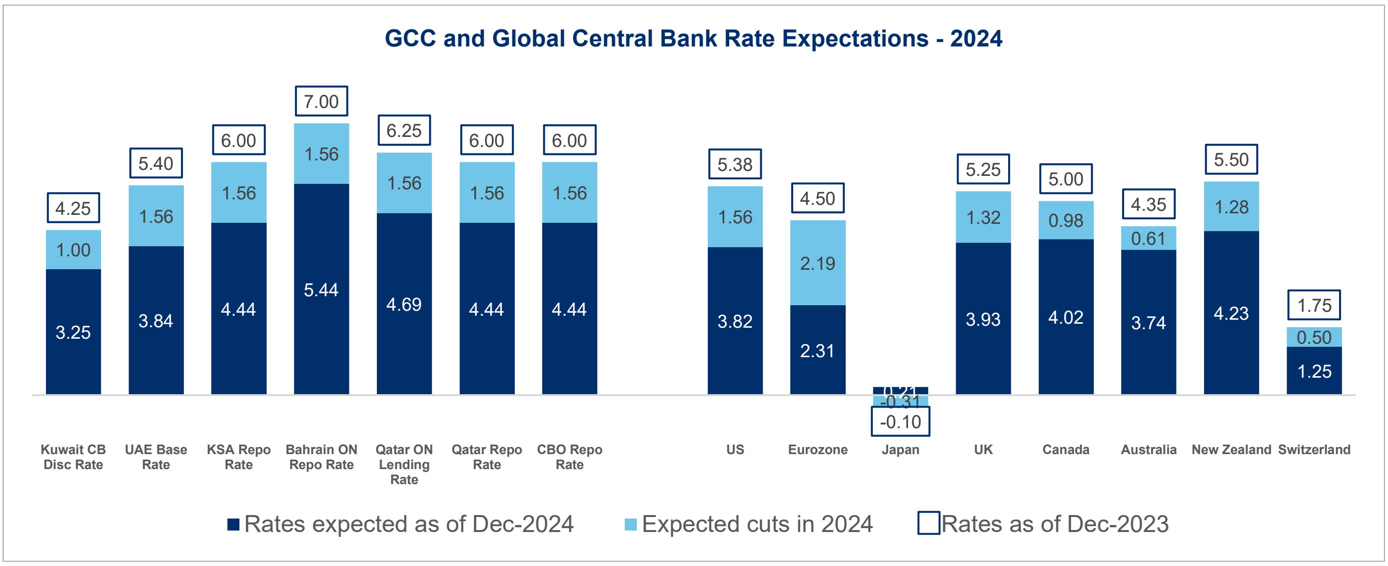


Sources : Bloomberg, Kamco Invest Research

Aggregate issuances from 1-January-2023 until the third week of December-2023 stood at USD 107.8 Bn as compared to USD 90.0 Bn during 2022, resulting in an increase of USD 17.8 Bn or 19.7%. The increase was mainly led by higher corporate issuances that went up from USD 40.5 Bn in 2022 to USD 66.2 Bn in 2023. On the other hand, government issuances dropped by 15.9% or USD 7.9 Bn in 2023 to reach USD 41.6 Bn as compared to USD 49.5 Bn in 2022. In terms of type of issuance, both bond and sukuk issuances witnessed growth during the year. Aggregate GCC bond issues went up by 43.7% or USD 17.6 Bn to reach USD 58.0 Bn as compared to USD 40.4 Bn in 2022. Sukuk issuances, on the other hand, witnessed marginal growth during the year to reach USD 49.8 Bn. At the country level, Kuwait, Qatar and Oman reported declines in issuances in 2023 vs. 2022 while the rest of the GCC countries witnessed growth. UAE issuers reported the biggest absolute growth in fixed income issuances this year with an increase of USD 18.4 Bn or 77.4% to reach USD 42.2 Bn in issuances. Saudi Arabia reported a small growth of USD 0.8 Bn or 1.5% but remained the biggest issuer this year with aggregate bonds and sukuk issuances reaching USD 52.1 Bn in 2023.

Outlook - Fed vs. GCC rate moves

The consensus estimates on policy rates by major central banks shows cuts across the globe in 2024 ranging from over 200 bps to 50 bps. According to Bloomberg consensus estimates, the US Fed is forecasted to lower rates by 156 bps in 2024 and end of year rates are forecasted to be at 3.82%. The Eurozone is forecasted to make more aggressive rate cuts next year slashing policy rates by 219 bps with end of year rates reaching 2.31%. Similarly, the UK, Canada and New Zealand are forecasted to lower rates by around 100 bps next year. For the GCC, we have forecasted rates based on US Fed rate cuts. As a result, most central banks in the GCC would slash rates in line with the US Fed due to the pegged currencies. However, Kuwait has its currency pegged to a basket of currencies. As such, we've forecasted a 100 bps cut by the Kuwait Central Bank in its discount rate. This is lower than the cuts in the rest of the GCC countries as Kuwait has made the smallest aggregate rate hike in the GCC since 2022 (275 bps) and since the start of the year (75 bps) and we believe that the roll back of rates would also be smaller than the rest of the GCC.



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Kamco Investment Company - K.S.C. (Public)
Al-Shaheed Tower, Khalid Bin Al-Waleed Street- Sharq
P.O. BOX : 28873, Safat 13149, State of Kuwait
Tel: (+965) 2233 6600   Fax: (+965) 2249 2395
Email : research@kamcoinvest.com
Website : www.kamcoinvest.com