KAMCO INVEST

Investment Strategy & Research

GCC Fixed Income Market Update

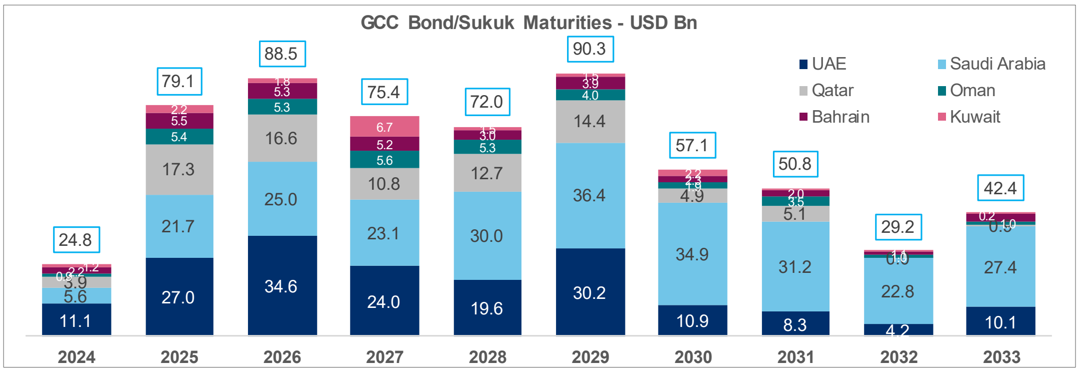
July-2024

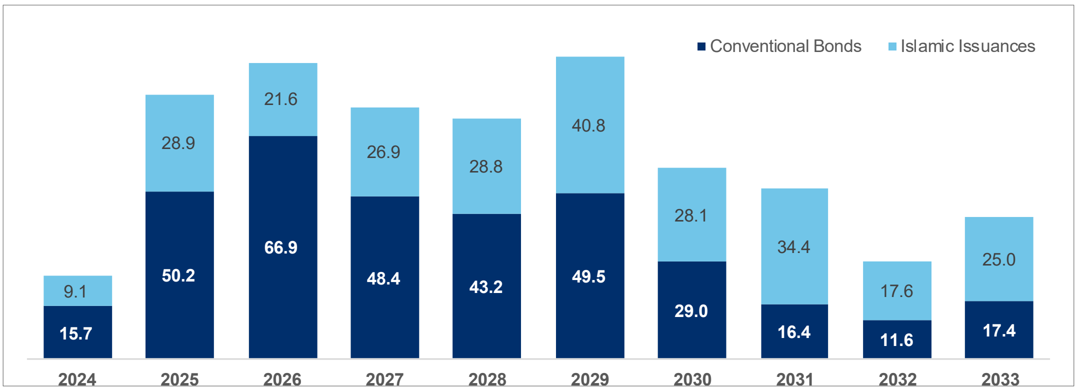
Bond market awaits cues on second rate cut as Sep-24 cut priced in...

Global bond markets are expected to see a confluence of expected fiscal policy, post the elections in the US, and the most likely monetary policy in light of the recent data on inflation. For the latter, the markets are pricing in a 25 bps Fed rate cut in the September-2024 meeting with a probability of over 90%. Traders are also eyeing the data on PCE and the trend in future inflation that would determine the rate path beyond September-2024. *For the near term, the key question would be that how much the economy is slowing and how would that impact the Fed's policy making. There is also a risk of going in for rate cuts too early and by too much. As of now, policymakers in the US are expected to keep interest rates unchanged for the eighth meeting next week and keeping the rates at current level since the last one year. In terms of market implied rates, the rate cut expected in September-2024 has narrowed the spread between longer dated treasury bonds and two-year bonds to one of the lowest levels since the start of the year. Elsewhere, the ECB, after having implemented its first rate cut in June-2024, kept rates stable during July-2024. China, meanwhile, implemented a surprise rate cut this week to give a boost to the economy and its financial markets.*

In the GCC, there is minimal pressure on currency pegs as seen from short term rates and as such, the central banks are expected to replicate Fed's policy on future interest rates. A rate cut would essentially benefit banks in the region that have recently started feeling the heat of higher interest rates. *In addition, the strong pipeline of projects would also result in an increase in issuances as lower interest rates would motivate corporate issuers to issue debt towards the end of the year. The recent trend in oil prices that hovered over the USD 80/b mark also indicate that governments in the region would continue to tap the fixed income market to finance investment requirements.*

In the primary market, GCC bonds and sukuk issuances continued to exceed our expectations with record issuances from the region backed by several big-ticket issuances during the first half of the year. Issuances during the first six months of 2024 exceeded full year 2023 levels to reach USD 113.7 Bn and were almost double when compared to y-o-y issuances during 1H-2023. Total issuances witnessed y-o-y growth across the board when compared to 1H-2023. Saudi Arabia accounted for almost 50% of the y-o-y growth in issuances during 1H-2024 followed by UAE and Qatar accounting for the rest.





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

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Inflation and interest rate hikes

The trend in inflation remained uneven since the start of the year. The year started with a decline in inflation but that was followed by two consecutive months of growth, thereby derailing the progress made last year. The decline that followed during the subsequent two months were also lower than market expectations that resulted in several economists completely ruling out any chances of a rate cut this year. However, the decline in PCE during May-2024 followed by lower-than-expected inflation during June-2024 once again revived up rate cuts bet. The probability of a rate cut in September-2024 saw significant change going up to 95% as we speak from around 50% a few weeks back. The y-o-y CPI for the US for June-2024 came in at 3.0%, the lowest level since 2021 led by a long-awaited slowdown in rent increases. In terms of m-o-m performance, the CPI declined by 0.1% as against consensus expectation of an increase of 0.1%. The figures for core CPI were also better than expected at +3.3% y-o-y and +0.1% m-o-m, the smallest advance in three years, also aided by cheaper gasoline prices and a fall in service prices. In addition, unemployment claims also increased, indicating a rapidly cooling labor market and a build-up of stress in the economy. In the euro area, June-2024 inflation came in at 2.5% down from 2.6% in May-2024 while core inflation stayed at 2.9% from the prior month, missing analyst estimates of 2.8%. Persistent services inflation that held up at 4.1%, in line with May-2024, was the key reason for the higher than expected reading and was mostly driven by Germany. The HICP inflation in Germany dropped to 2.5% during June-2024 from 2.8% in the previous month led by fall in fuel costs. However, sticky wages, core inflation is expected to show slower progress than headline inflation. In the UK, inflation came in above expectation at 2.0% during June-2024, in line with May-2024 which was the lowest reading in three years. Both services inflation and core inflation held up at May-2024 levels at 5.7% and 3.5%, respectively.

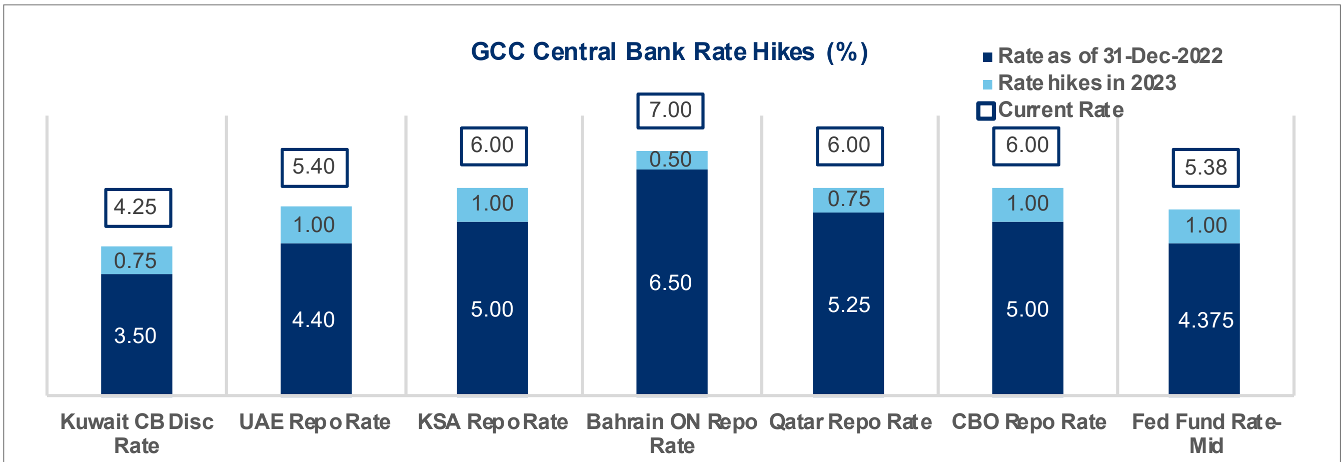
In terms of interest rate cuts, the consensus is pricing in one rate cut in September-2024 in the US with a 95.5% probability followed by another rate cut in December-2024, also with a high probability of 91.2%. In the euro area, consensus estimates show two more rate cuts this year with a probability of over 75.0%. Nevertheless, inflation reading for the next few months would determine the rate cut path to be adopted by the ECB which as clearly said that inflation would determine future interest rates. The stubborn inflation in the UK has prompted traders to axe a rate cut in August-2024 resulting in a boost for the GBP as rates continue to remain higher.

GCC - Sovereign Credit Ratings Profile

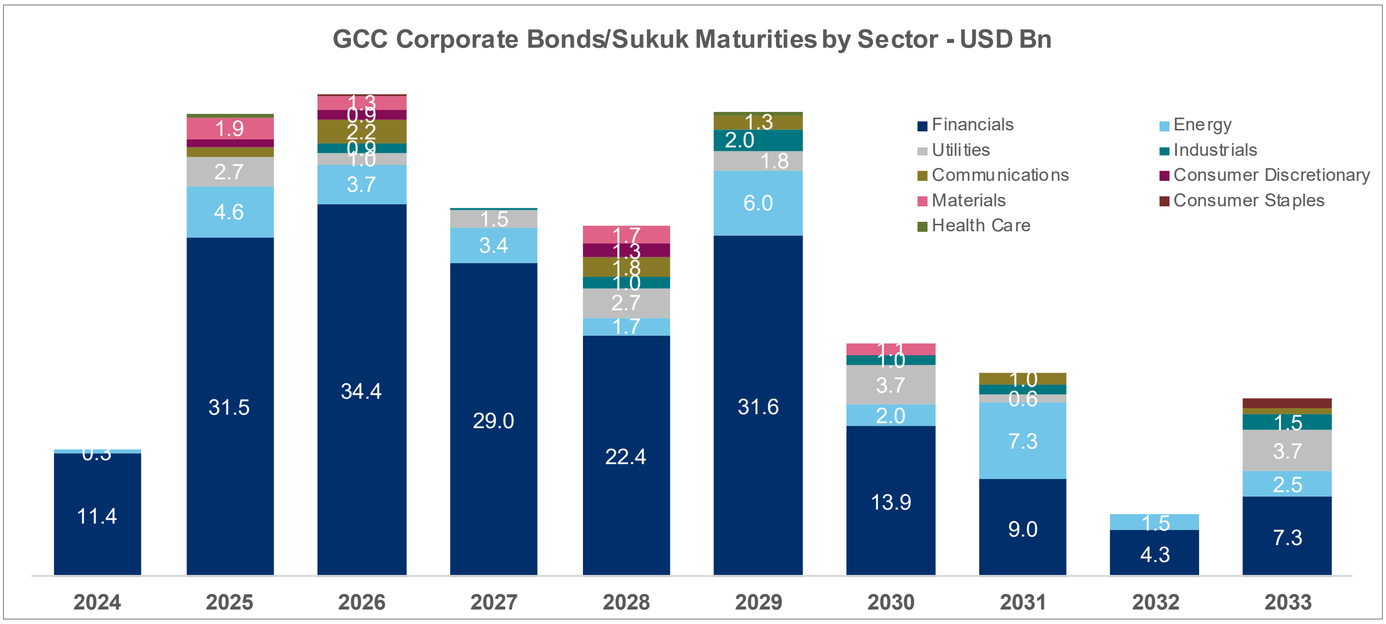
	S&P		Moody's		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Bahrain	B+	STABLE	B2	STABLE	B+	STABLE
Kuwait	A+	STABLE	A1	STABLE	AA-	STABLE
Oman	BB+	POS	Ba1	STABLE	BB+	STABLE
Qatar	AA	STABLE	Aa2	STABLE	AA	STABLE
Saudi Arabia	A	STABLE	A1	POS	A+	STABLE
UAE	NR	NR	Aa2	STABLE	AA-	STABLE
Abu Dhabi	AA	STABLE	Aa2	STABLE	AA	STABLE

Sources : Bloomberg, Kamco Invest Research

In the emerging market, inflation in China came in at just 0.2% indicating weak consumer demand in the country. This prompted the PBOC to implement a surprise rate cut this week in the hopes of supporting economic growth in the country. This was the first reduction in almost a year and although economists believe this to have limited impact, they said the move is in the right direction and more needs to be done to boost economic growth. On the other hand, CPI in India rose to 5.1% in June-2024 from 4.8% in May-2024, reversing a consistent downward trend seen since December-2023. The increase came despite a fall in core inflation to 3.3% during the month and was mainly led by elevated food prices. The higher-than-expected inflation is likely to delay rate cuts by India's central bank to later during the year.



Sources : Bloomberg, Kamco Invest Research



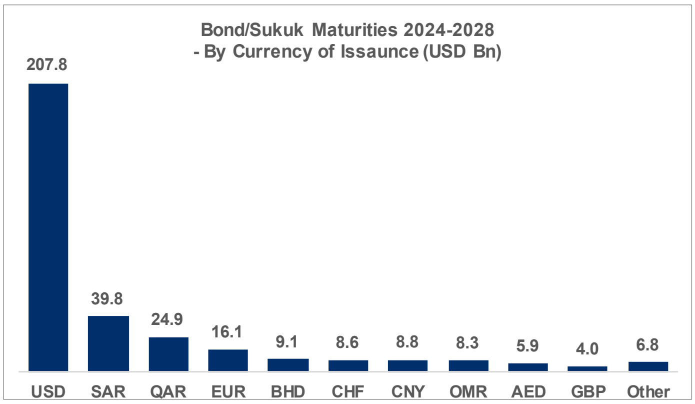
Sources : Bloomberg, Kamco Invest Research

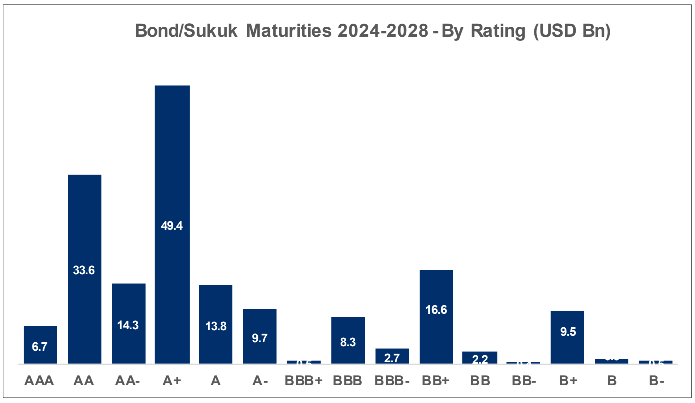
Bond/Sukuk Maturities

Fixed income maturities in the GCC are expected to remain elevated over the coming five years backed by issuances made during the pandemic years aimed at supporting economic growth as seen globally. According to data from Bloomberg, GCC sovereign maturities stands at USD 174.3 Bn over the next five years (2024-2028), whereas corporate maturities stand slightly lower at USD 165.5 Bn. Bonds and sukuk maturities in the region are expected to remain elevated until 2029 followed by a steep decline starting from 2030. A majority of these maturities are denominated in USD at 61.1% followed by local currency issuances in SAR and QAR at 11.7% and 7.3%, 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. Around 40.9% of the overall maturities in the coming five years are for investment grade instruments. In terms of type of instruments, conventional bonds dominate with USD 224.5 Bn in maturities over the next five years, whereas sukuk maturities are expected to be at USD 115.3 Bn. In terms of country split, the UAE is expected to see the biggest fixed income maturities in the coming years (2024-2028) at USD 116.3 Bn followed by Saudi Arabia which is forecasted to see maturities of USD 105.3 Bn until 2028. Maturities in Qatar and Oman were next at USD 61.3 Bn and USD 22.4 Bn, respectively.

In terms of sector maturities, Banks and other Financial Services sector have USD 128.6 Bn in maturities in the next five years, accounting for around 77.7% of the total corporate maturities and 37.8% of the total maturities in the GCC until 2028, respectively. The Energy sector was a distant second with maturities of USD 13.7 Bn or 8.3% of GCC corporate maturities until 2028 followed by Utilities and Communications at USD 7.9 Bn and USD 5.0 Bn, respectively.

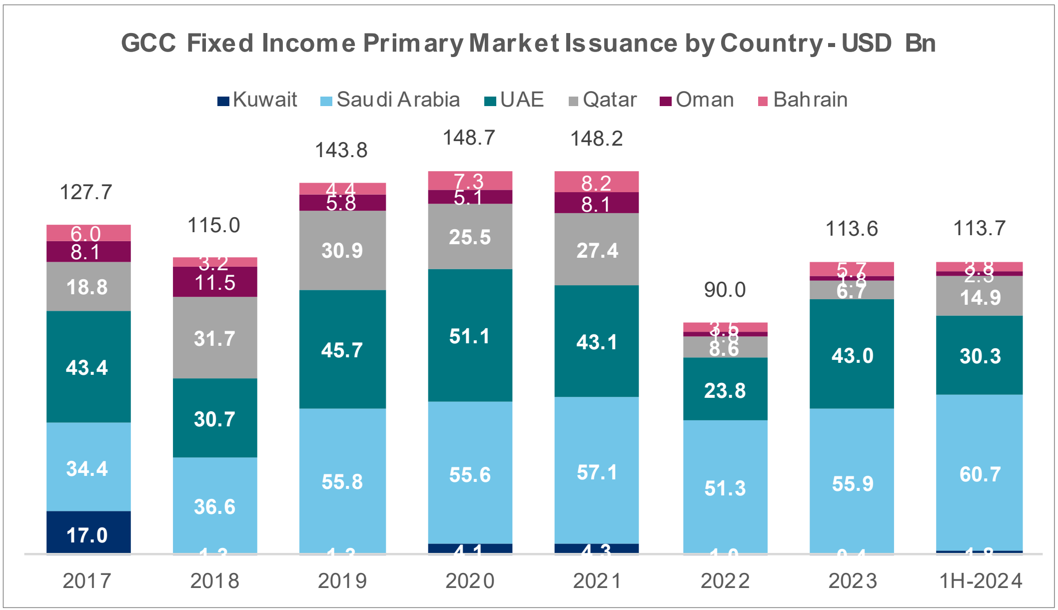
Banks in the region were once again leading in terms of issuances and consequently maturities in the coming years. Banks in the UAE reported the biggest maturities over the next five years at USD 53.4 Bn followed by Qatari banks with maturities of USD 20.4 Bn. Banks in the two countries accounted for 21.7% 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 5.9 Bn and USD 2.4 Bn, respectively, until 2028.





Sources : Bloomberg, Kamco Invest Research

The structure of maturities saw perpetual instruments seeing consistent growth until 2022 but witnessed a decline in the subsequent years. Issuance of perpetual bonds by corporates reached USD 1.1 Bn in 1H-2024 vs. USD 1.4 Bn in 2023. On the other hand, issuances of perpetual corporate sukuks witnessed growth this year as compared to a three year low level reached during 2023. Total perpetual corporate sukuk issuances reached USD 3.6 Bn in 1H-2024 as compared to full year issuances of USD 2.7 Bn in 2023.

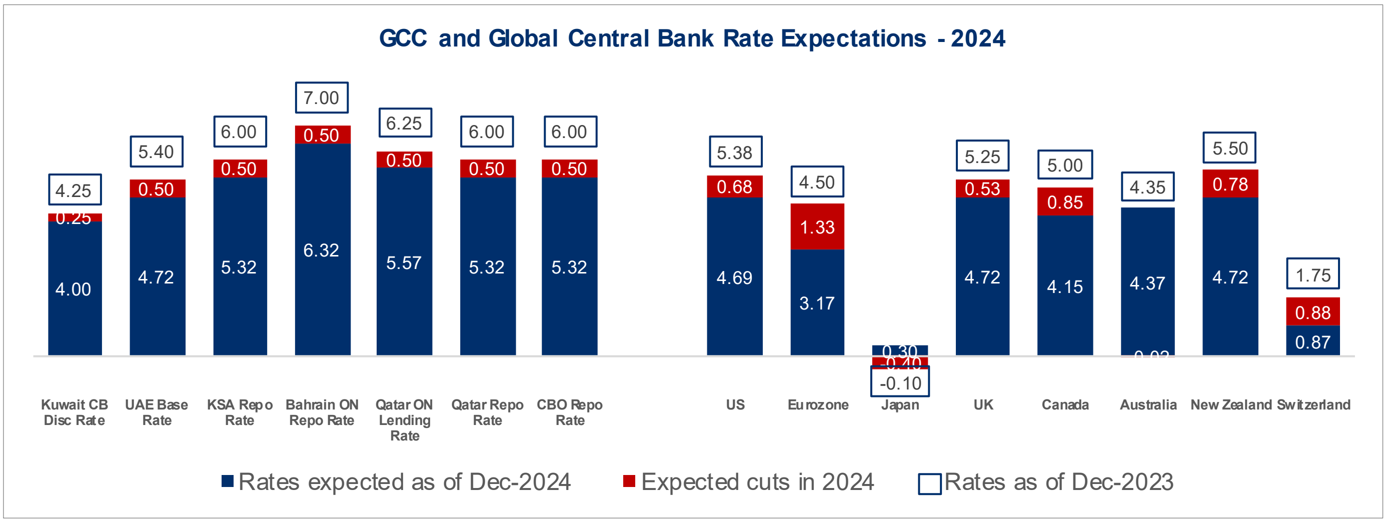


Sources : Bloomberg, Kamco Invest Research

Issuances in 1H-2024

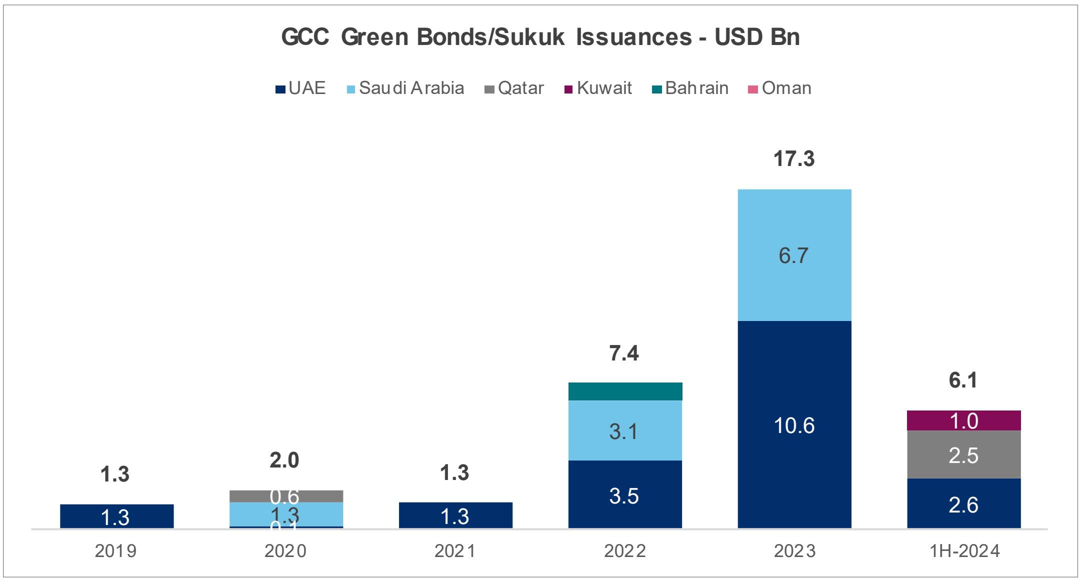
Aggregate issuances during the first six months of the year stood at a record high of USD 113.7 Bn, almost double the issuances during 1H-2023 that stood at USD 59.6 Bn as well as overtook full year 2023 issuances of USD 113.6 Bn. The increase was mainly led by higher government issuances during 1H-2024 that went up from USD 24.4 Bn in 1H-2023 to USD 62.1 Bn in 1H-2024. On the other hand, corporate issuances also increased, albeit at a smaller rate of 46.5% or by USD 16.4 Bn to reach USD 51.6 Bn during 1H-2024 as compared to USD 35.2 Bn during 1H-2023. In terms of type of issuances, both bond and sukuk issuances witnessed growth during the year. Aggregate GCC bond issuances went up by 65.2% y-o-y or USD 23.1 Bn to reach USD 58.5 Bn in 1H-2024 as compared to USD 35.4 Bn in 1H-2023. Sukuk issuances, on the other hand, more than doubled with a solid growth of 127.9% or USD 31 Bn to reach USD 55.2 Bn during 1H-2024 as compared to USD 24.2 Bn during 1H-2023.

At the country level, almost all the countries in the GCC reported higher issuances during 1H-2024, barring Bahrain, that showed flattish y-o-y issuances. The biggest absolute growth in issuances was seen in Saudi Arabia with total issuances of USD 60.7 Bn in 1H-2024, a record high for the Kingdom, as compared to USD 33.8 Bn during 1H-2023. Saudi Arabia was also the biggest issuer in global emerging market space, overtaking China in overall bond/sukuk sales during 1H-2024. Within Saudi Arabia, the growth was solely led by government issuances that reached USD 43.1 Bn during 1H-2024 as compared to USD 16.1 Bn during 1H-2023. The Kingdom largely took the sukuk route to raise money this year with total sukuk issuances reaching USD 29.4 Bn during 1H-2024 as compared to USD 6.0 Bn during 1H-2023 while bond issuance showed relatively smaller growth to reach USD 13.7 Bn during 1H-2024 vs. USD 10.1 Bn during the corresponding period last year. Corporates in the Kingdom also focused on sukuk issuances that reached USD 11.3 Bn this year as compared to USD 9.0 Bn during 1H-2023 while corporate bonds showed a decline with total issuances of USD 6.3 Bn this year vs. USD 8.8 Bn in the corresponding period in 2023. UAE and Qatar were next at the country level with y-o-y issuance growth of USD 12.5 Bn and USD 11.4 Bn to reach total issuances of USD 30.3 Bn and USD 14.9 Bn, respectively, during 1H-2024.



Sources : Bloomberg, Kamco Invest Research

In terms of issuances of green instruments, the year witnessed a steep decline as compared to last year. Aggregate issuances of green bonds and sukuk in the GCC reached USD 6.1 Bn in 1H-2024 as compared record issuances of USD 17.3 Bn during full year 2023. Qatar, which started issuance of green instruments after a gap of three years, topped this year with total issuances of USD 2.5 Bn followed by UAE and Kuwait with green issuances of USD 1.8 Bn and USD 1.0 Bn, respectively. In terms of type of issuer, governments in the region took the lead with total green bonds issuances reaching USD 3.25 Bn as compared to corporate issuances of USD 2.8 Bn. Comparatively, the issuance of green bonds reached USD 387.0 Bn during 1H-2024, according to a Bloomberg report, once again led by an increase in issuances from governments. As per the report, the EMEA region led the issuances of green instruments supported by both debut and repeat sovereign issuers, while Euro was the leading currency.



Sources : Bloomberg, Kamco Invest Research

Outlook - Imminent rate cuts but diverging policies

With inflationary pressure expected to ease during 2H-2024, we expect to see more global central banks implementing rate cuts to support economic growth. According to Bloomberg, global inflation is expected to peak at 6.9% in Q2-2024 and is expected to ease to 5.5% by the end of the year. That said, individual country policies are expected to diverge as the pace of slowdown in inflation varies amongst countries. This includes an early rate cut announced by ECB followed by rate cut expected by the US Fed in September, while the PBOC already announced a surprise rate cut this week. On the other hand, Bank of England and India's central bank are expected to delay rate cuts despite an urgent need to boost economic growth as the effects of higher interest rates are already visible in certain sectors, including the biggest impacted real estate sector. These likely policy measures are also reflected in the expected market implied interest rates for key global central banks. The US is expected to implement at least two rate cuts this year, as per consensus estimates, while the ECB would likely make two additional cuts along with the one in June-2024. Since a majority of the central banks in the GCC are aligned with the Fed policy due to the pegged currencies, we expect GCC central banks to follow suit with two rate cuts this year. Kuwait's central bank is likely to implement one rate cut this year.

In terms of issuances, we expect a record year for the GCC as issuances during 1H-2024 have already exceeded last year's level. We expect aggregate issuances to breach the USD 150 Bn mark by the end of the year as corporate issuances are expected to tap the market towards the end of the year as rate cuts are implemented. Sovereign issuances, meanwhile, are expected to retreat as compared to 1H-2024 levels. The remainder of the year would see maturities of USD 24.8 Bn that is almost equally split between governments and corporates. Green bonds remain one of the areas of interest for GCC issuers with this year's issuance by Qatar government. HSBC was one of the arrangers of the green bond and said that other countries in the GCC could follow either this year or next. Oman's ministry of finance has already prepared a sustainable finance framework under which it intends to borrow.

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