GCC Fixed Income Market Update

July-2021

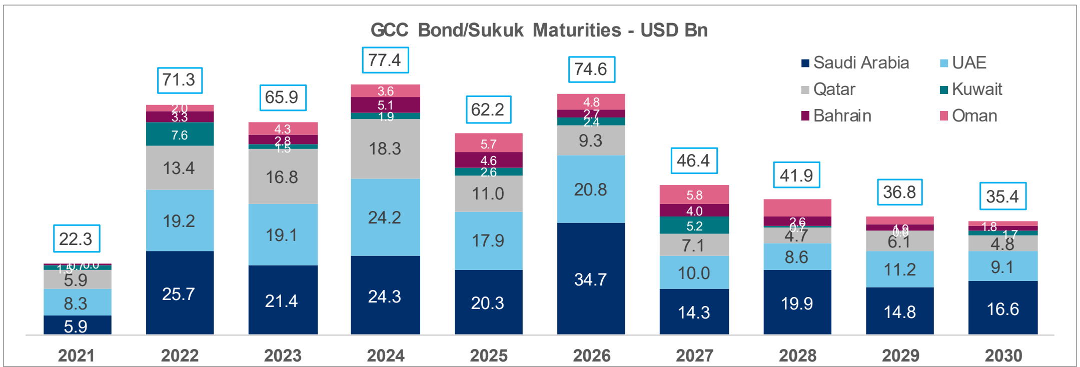
GCC bond/sukuk issuances expected to decline in 2021...

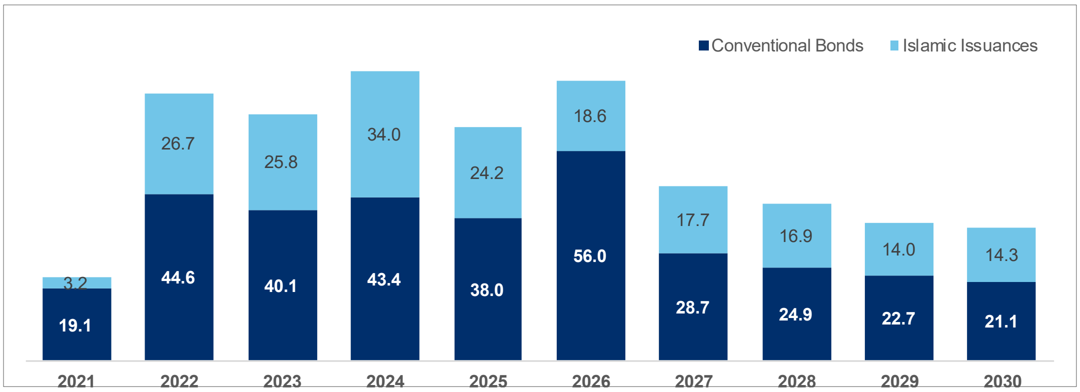
GCC issuances in 2020 showed flattish growth as compared to 2019 and this came despite the pandemic resulting in record decline in oil prices and record high fiscal deficits. One of the key reasons was that debt had reached record high levels in the region as well as globally and there were significant uncertainties related to the future course of the pandemic and the development of vaccines. As a result, government slowed down its issuances while corporates piled on debt during 2H-2020 for business investments as well as to take advantage of low rates.

This scenario further evolved as we entered 2021 with the successful development of several vaccines in addition to a slowdown in the spread of the virus as a result of the restrictions and lockdowns. The pace of vaccinations has accelerated globally and in the GCC with close to 0.3 Mn vaccination doses being administered daily in Saudi Arabia, UAE, Qatar and Bahrain. New cases have also shown a significant decline in the region, although uncertainties relating to new variants continue to haunt authorities resulting in new travel restrictions.

***The trend this year has so far remained in line with 1H-2020 levels with total issuances at USD 80.0 Bn. However, unlike last year where governments dominated the fixed income market, the bulk of the issuances this year were from corporates. Private businesses raised close to USD 50 Bn as against USD 30 Bn from the government in 1H-2021.** The motivation behind higher corporate issuances were apparent including the low interest rates, recovering economy and a push from the regional government to accelerate vaccinations and kickstart the economy.*

***Expectations for the remainder of the year remains slightly muted. We expect government issuances to slow down, led by higher oil prices that is easing pressure on the fiscal front, although we can still see opportunistic issuances from the government to take advantage of low rates. Corporates, on the other hand, are expected to see growth vs. last year but that may not fully offset the decline from government issuers during 2H-2021.** Data from Bloomberg showed that GCC government and corporate fixed income instrument maturities at USD 22.3 Bn for the remainder of the year. This will easily push issuances over the USD 100 Bn mark for the full year. In addition, there are significant deals in the pipeline that would add to total issuances but is expected to fall short of last year's levels.*





Sources : Bloomberg, Kamco Invest Research

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Rating actions and interest rates

The lifting of restrictions and the economic recovery had minimal impact on sovereign rating actions by credit rating agencies. According to data from Bloomberg, this year almost 28 sovereign ratings downgrade actions were taken by the rating agencies as against 11 upgrades. Sovereigns continue to have largely lose monetary policies by keeping interest rates at extremely low levels in order to provide a boost to spending and investments and, as a result, fiscal deficit has increased.

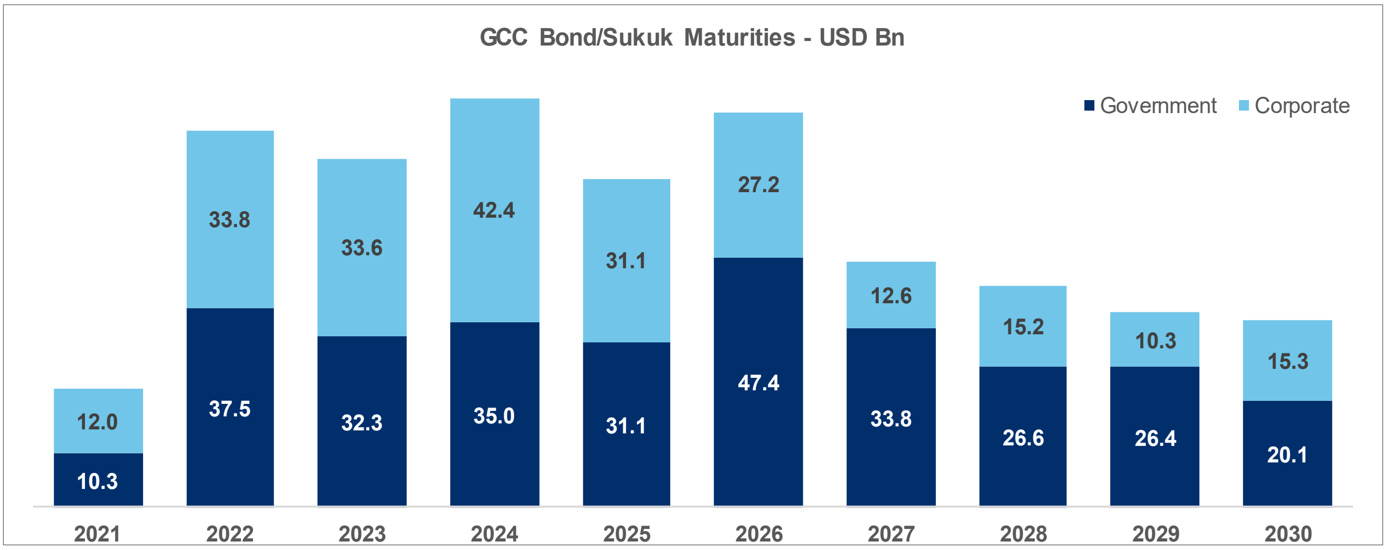
GCC - Key Central Bank Rates vs. US Fed Fund Rate							
Dates	Kuwait CB Disc Rate	UAE Repo Rate	KSA Repo Rate	Bahrain ON Repo Rate	Qatar Repo Rate	Oman CBO Repo Rate	US Fed Fund Rate
Dec-18	3.00	2.75	3.00	4.50	2.50	3.01	2.25 - 2.5
Dec-19	2.75	2.00	2.25	4.00	2.00	2.28	1.5 - 1.75
Dec-20	1.50	0.60	1.00	2.25	1.00	0.50	0 - 0.25
Jun-21	1.50	0.65	1.00	2.25	1.00	0.50	0 - 0.25
1-Yr Change (%)	0.00	-0.10	0.00	0.00	0.00	0.00	0
2-Yr Change (%)	-1.50	-2.10	-2.00	-2.25	-1.50	-2.40	-2.25

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

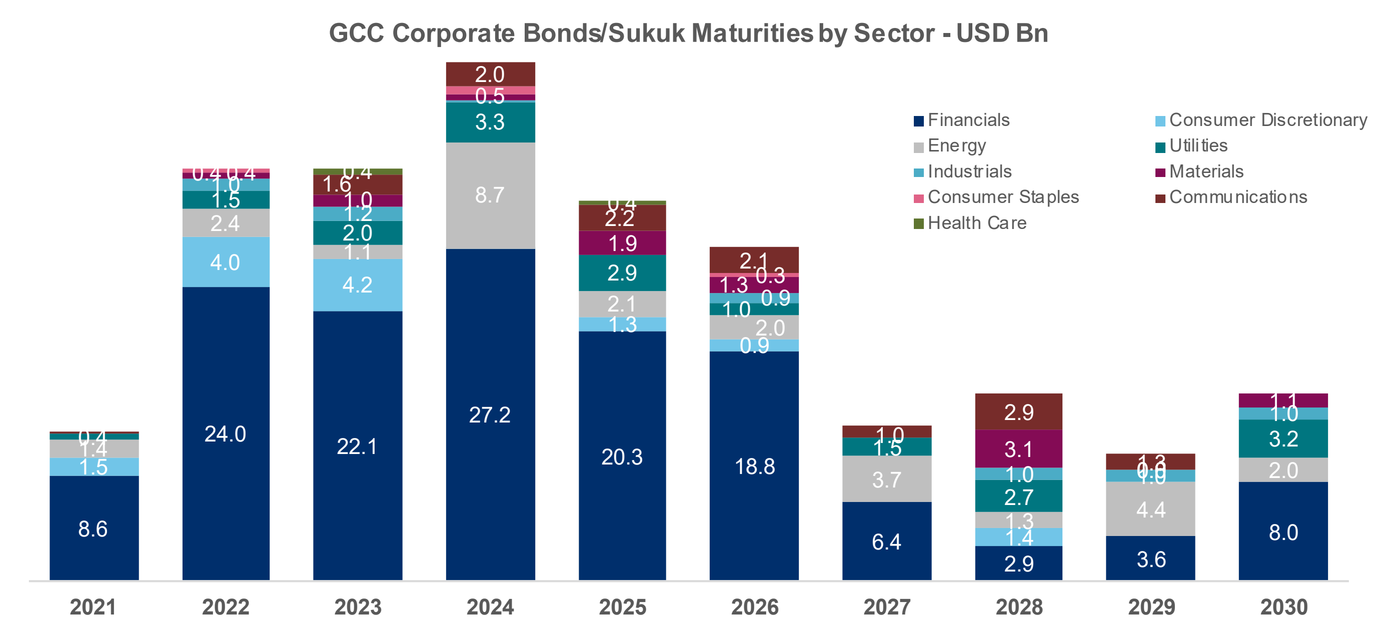
Sources : Bloomberg, Kamco Invest Research

Nevertheless, the US has hinted on unwinding of its low interest rate policies and could make rate hikes in 2023. One of the key reasons for the earlier-than-expected rate hikes could be the rising inflation in the US that is higher than the long-term average as targeted by the US Fed. According to a report from FT, economists are expecting at least two rate hikes in 2023 and this is in line with the latest dot plot, although the US government insisted that it would keep the policy highly accommodative. The so-called "commodity super cycle" was reflected in the Bloomberg Commodity Spot Index that is currently at a 10-year high. Commodity prices had increased across the board globally, although some commodities have now cooled off after peaking in May-2021.

Sovereign ratings for the GCC countries have remained largely stable this year but there were a few outlook revisions mainly to a 'Negative' outlook. Bahrain's outlook was downgraded to 'Negative' from stable by S&P in May-2021 mainly reflecting the pace of fiscal reforms. Earlier in April-2021, Moody's also downgraded Bahrain's outlook to Negative highlighting larger-than-earlier-expected weakening in fiscal metrics and the ongoing uncertainty around the timing and the size of the augmentation of the financial support package for Bahrain from the GCC countries. The outlook on Kuwait was also revised to Negative by Fitch in February-2021 reflecting near-term liquidity risks associated with the depletion of liquid assets in the GRF due to the government's inability to borrow. Kuwait, nevertheless, enjoys the highest credit rating in the region from Fitch, along with Abu Dhabi, at AA. In a recent report, Moody's said that the GCC countries would remain heavily dependent on hydrocarbon production in the near future that would be a key credit constraint for the region. The agency said that although the pace of diversification would accelerate, it would be affected by reduced availability of resources to fund the diversification efforts in a low oil price environment. In terms of interest rates, key policy rates in the GCC have remained stable over the last one year after witnessing cuts across the board ranging from 125 bps to 175 bps during 1H-2020.



Sources : Bloomberg, Kamco Invest Research



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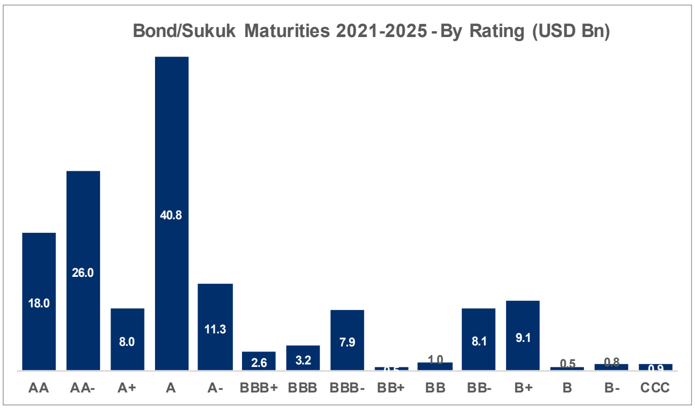
Bond/Sukuk Maturities

GCC governments are expected to see USD 146.2 Bn in fixed income maturities over the next five years (2021-2025), whereas corporate maturities stand at slightly higher USD 152.9 Bn. A majority of these maturities are denominated in USD at 60.2% followed by local currency issuances in SAR and QAR at 18.6% and 8.1%, 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 185.2 Bn in maturities over the next five years, whereas sukuk maturities are expected to be at USD 113.9 Bn. Both bond and sukuk maturities are expected to remain elevated starting from 2022 until 2026 and then gradually taper for the rest of the tenor. 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 97.6 Bn until 2025 followed by UAE and Qatari issuers at USD 88.7 Bn and USD 65.3 Bn, respectively.

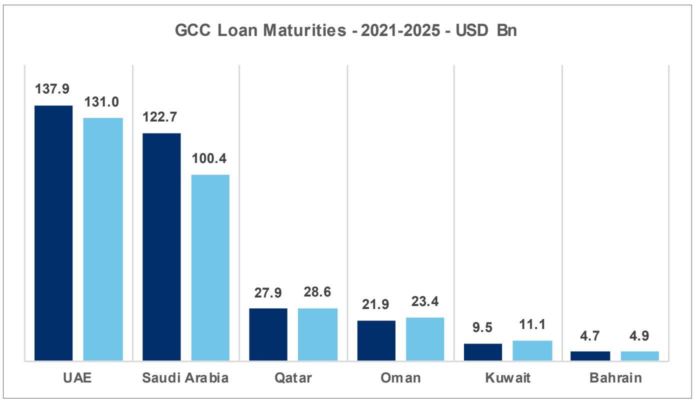
In terms of sector maturities, Banks and other Financial Services sector have USD 88.5 Bn in maturities in the next five years, accounting for around 49.4% of the total corporate maturities and 29.6% of the total maturities in the GCC until 2025. The Energy sector was next with maturities of USD 15.7 Bn or 10.3% of GCC corporate maturities until 2025 followed by Airlines and Utilities at USD 11.0 Bn and USD 10.1 Bn, respectively. Banks in UAE have the biggest maturities over the next five years at USD 41.0 Bn followed by Qatar at USD 24.5 Bn. Banks in the two countries accounted for 21.9% of total bond/sukuk maturities over the next five years in the GCC. Real Estate maturities are also concentrated mainly in the UAE and Saudi Arabia at USD 6.9 Bn and USD 2.2 Bn, respectively, until 2025.

The structure of maturities are also changing gradually as an increasing number of issuances are perpetual instruments. According to data from Bloomberg, perpetual issuances have seen growth for the seventh consecutive year in 2021. Issuances reached record levels during 1H-2021 at USD 8.5 Bn as compared to USD 6.4 Bn in 2020. Adding maturities beyond 30 years or from 2050 onwards, the issuances totaled USD 14.6 Bn in 1H-2021 vs. USD 39.8 Bn in 2020.



Sources : Bloomberg, Kamco Invest Research

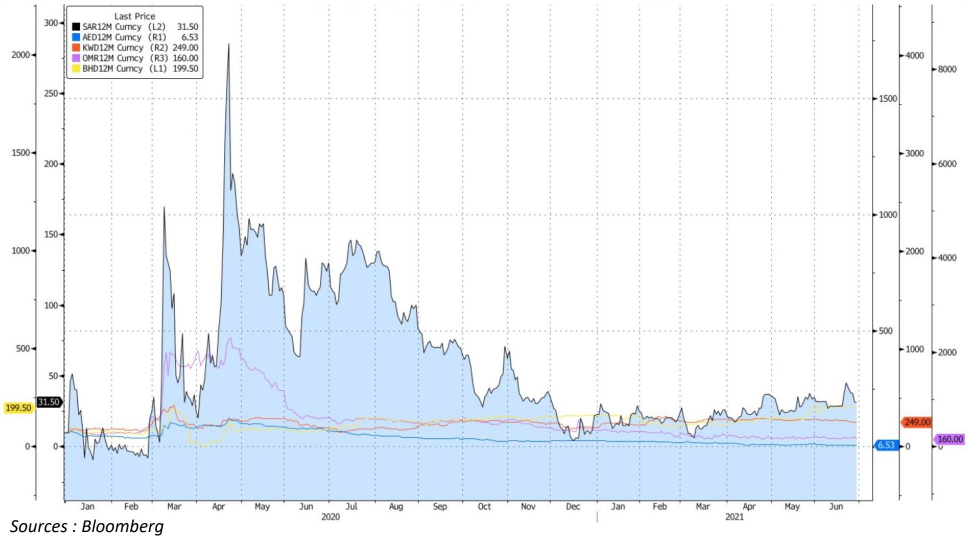
Loan maturities in the GCC over the next five years have seen a steep increase since the start of 2021. Total maturities has increased by 8.4% or USD 25.3 Bn to USD 324.6 Bn as of the end of June-2021 as compared to USD 299.3 Bn at the end of 2020. UAE corporates account for the bulk of the scheduled repayments over the next five years at USD 137.9 Bn followed by Saudi Arabian and Qatari corporates with scheduled repayments of USD 122.7 Bn and USD 27.9 Bn, respectively. Saudi Arabia has seen the biggest increase in loans since the start of 2021 with a jump of 22.3% or USD 22.4 Bn to a total amount of USD 122.7 Bn. Both UAE and Saudi Arabia reported an increase in loan maturities this year while the rest of the GCC countries have reported declines.



Sources : Bloomberg, Kamco Invest Research

Currency market favors stability in the near-term that supports local market issuance...

After a tumultuous 2020 that saw significant pressure on GCC currency pegs against the USD at the peak of the pandemic, recent trends show stability across the board. The 12 month forward rates for most of the GCC currencies show pressure easing over the last few months and the currency premiums are at multi-year low for most of the GCC currencies. The trend was mainly led by higher oil prices, in addition to the resumption in economic activity in the region. In our opinion, stable exchange rates should favor issuers eying local market bonds/ sukuks in the region with minimal currency risk in the near-term with maturities up to five years.

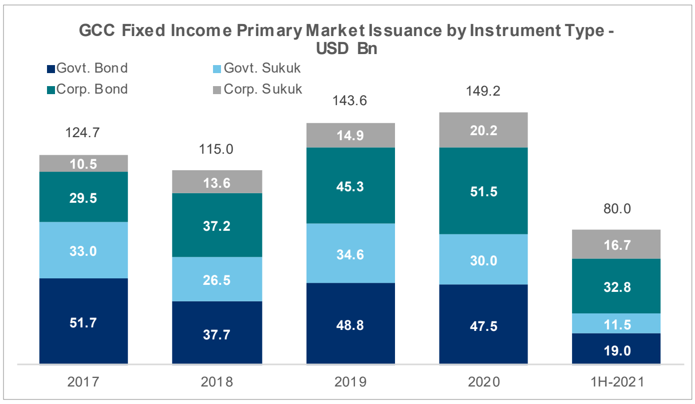


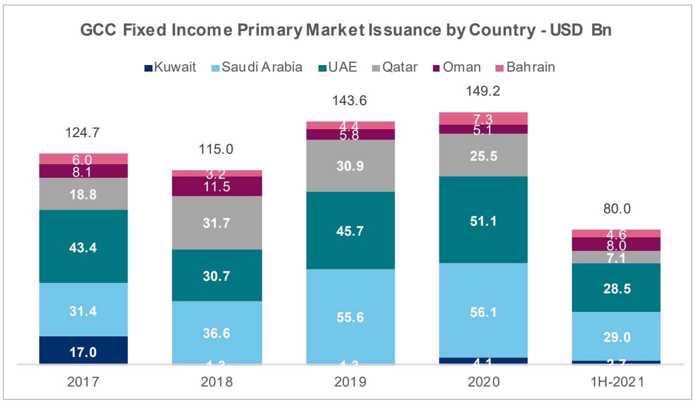
Sources : Bloomberg

Several studies have shown that how a strong local currency market can promote stability of local financial system, reduces currency and maturity mismatches, non-inflationary financing of deficits, reduction in the risk of the banking sector, promotes long term investments by pension funds and enable diversification of investments by such funds. That said, prerequisites for this includes, a strong secondary market for such securities, issuances primarily have a long-term tenor, issuances have fixed nominal interest rates and strong laws and regulations to protect investors. We believe that the bulk of the requirements are present in most of the financial markets in the region, including exchange for secondary trading of bonds and sukuks.

New issuances remain almost flat y-o-y in 1H-2021 vs. 1H-2020

Total fixed income issuances in the GCC stood at USD 80 Bn as compared to USD 149.2 Bn during 2020. Issuance were almost in line with the corresponding period in 2020 that stood at USD 82.2 Bn. Saudi Arabia and UAE remained the top fixed





Sources : Bloomberg, Kamco Invest Research

instrument issuers in the region at USD 29.0 Bn and USD 28.5 Bn, respectively, during 1H-2021. On the other hand, Qatar witnessed a steep decline during 1H-2021 with issuances at USD 7.1 Bn as compared to USD 25.5 Bn in 2020 and USD 18.3 Bn in 1H-2020. In terms of issuers, corporates overtook government issuers during 1H-2021 with issuances totaling USD 49.5 Bn as compared to USD 30.4 Bn for government issuers. Corporates witnessed a 59.2% y-o-y growth in issuances during 1H-2021 whereas government issuers reported a decline of 40.5%. In terms of type of instruments, the split of bond and sukuk issuance remained broadly in line with historical levels. Bond issuances stood at USD 51.7 Bn in 1H-2021 as compared to USD 44.2 Bn in sukuks.

Outlook

After an exceptional 2020 that witnessed one of the deepest economic slowdowns globally as well as in the region, GCC bond and sukuk issuances remained broadly stable y-o-y at USD 80.0 Bn during 1H-2021, although there were significant variations at the country level. Among the three biggest issuers in the GCC, UAE and Saudi Arabia continue to tap the fixed income market to fund budget deficits, while Qatar showed a steep decline in 1H-2021 issuances, following two consecutive year of declines in full year issuances in 2019 and 2020. The decline in Qatar came as its fiscal deficits were relatively smaller than other GCC peers.

For the remainder of the year, we expect to see a further slowdown in issuances in the GCC, mainly from the government, as oil prices continue to remain elevated at almost 3-year high levels over the USD 75/b mark. This would significantly reduce the government's infrastructure funding shortfall, thereby providing a much needed breather to the increasing debt-to-GDP ratio for the bulk of the GCC countries. Moreover, the funding requirements related to the pandemic were broadly met by reforms and other measures like loan moratoriums, relaxations of government duties and tapping of sovereign wealth funds as compared to direct debt issuances as seen in some of the developed countries. According to the IMF, fiscal deficit for the GCC countries is expected to decline from 9.2% of GDP to 3.0% of GDP in 2021 and further down to 1.4% in 2022. These estimates were made at a time when oil prices were just over the USD 60/b mark. With prices now significantly higher and consensus expectations of USD 67/b in Q3-2021 followed by USD 70/b for Q4-2021, higher oil revenues are expected to further lower deficits.

On the other hand, the expected accelerated economic recovery during 2H-2021 backed by vaccinations and lowered restrictions could result in higher business investments. Funding requirements are apparent in the equity market with the announcement of a number of IPOs recently, while the historical low interest rates provides equal motivation to tap the fixed income market for investment needs. This was seen during 1H-2021 where corporate issuance increased by 59% y-o-y while government issuances declined by 40.5%. In addition, a renewed trend toward PPP model of infrastructure development in the GCC further supports corporate issuances.

With 1H-2021 issuance of USD 80.0 Bn and an additional USD 22.3 Bn in refinancing requirements during 2H-2021, total issuances are expected to exceed the USD 100 Bn mark for the year. Added to this, the expectations of a faster recovery during 2H-2021 is expected to result in additional issuance, mainly from corporates. Moreover, the recent announcement of USD 12.5 Bn in bonds from Qatar Petroleum that received orders of USD 41 Bn shows that investor appetite for investment grade bonds from the GCC governments or GREs remain extremely strong. Nevertheless, despite the growth in corporate issuance, we expect to see a y-o-y decline in government issuances in 2021 and as a result full year issuances are expected to fall short of last year's levels.

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