GCC Fixed Income Market Update

May-2020

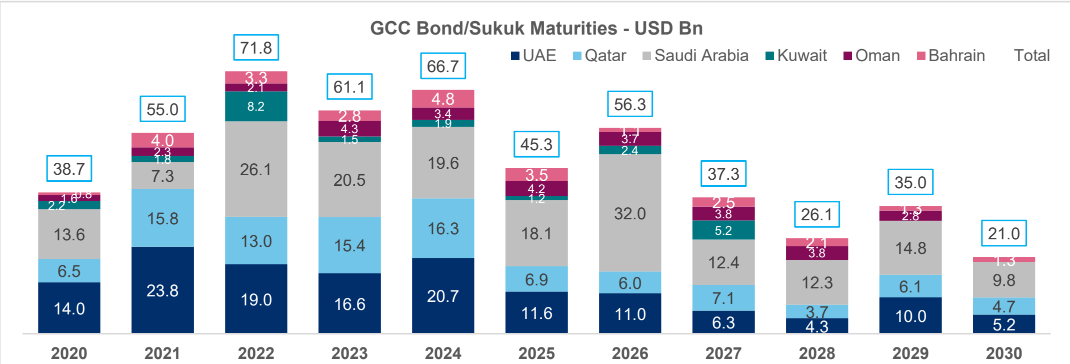
GCC financing needs likely to balloon in the near-term led by Covid-19...

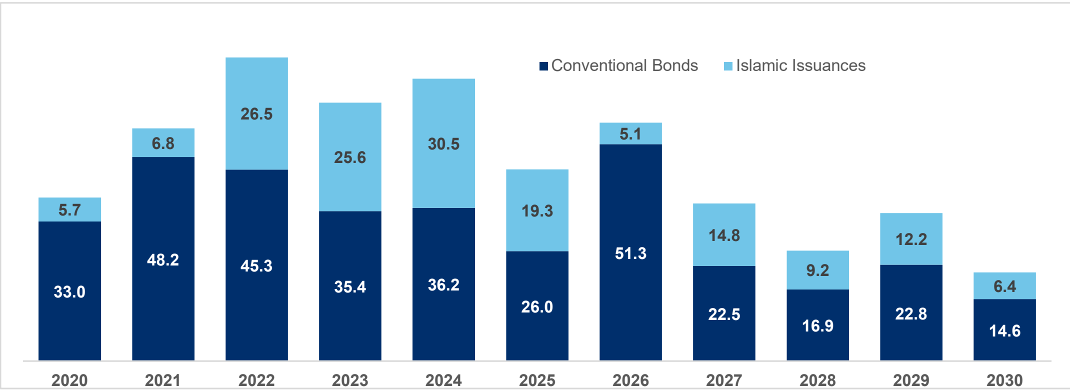
The outbreak of the Covid-19 pandemic and its economic impact on the countries across the globe has resulted in a reassessment of financial impact in light of new financial stress and the near-term uncertainty. *Governments have earmarked financial stimulus packages in varying amounts which is as high as 21% of GDP in the case of Japan followed by the US at 13% of the GDP or USD 2.7 Trillion. As we write this report, the number of Covid-19 cases reached 4.7 Mn, but there were also news of reopening of economies like China and Germany aimed at kickstarting economic recovery, along with plugging the hole made by spending in stimulus packages.*

The crisis comes at a time when global debt remains at historically high levels which is further expected to increase, led by bond-sponsored spending as countries deal with the pandemic. *According to a Bloomberg report, in the emerging markets, around USD 730 Bn is due through the rest of this year but with dwindling foreign reserves and low economic growth rates, it would become harder for some economies to maintain their external debt payments.*

The pandemic has choked new funding in the equity market space with new primary market issuances now taking a back seat awaiting better valuations in addition to the historic outflow of funds from the emerging markets. On the fixed income side, it has led to record low benchmark rates implemented in order to infuse liquidity in the system. However, the risk assessment of the once low-returns-safe-bet of the fixed income market has also changed.

The fiscal pressure from the decline in economic activity and lower oil revenues has forced GCC governments to issue sizeable debt. ***GCC governments have issued close to USD 31 Bn in bonds in YTD-2020 with USD 24 Bn in April-2020 alone and more than USD 10 Bn in sukuks.*** *Last year, the bond issuances by governments in the region totaled USD 48.8 Bn while sukuks issued were at USD 33.3 Bn. On the other hand, corporate issuances have been active with USD 19.0 Bn in bond issuances this year, including USD 6.6 Bn in May-2020, whereas sukuk issuances stood at USD 4.8 Bn. This compares to last year's USD 45.6 Bn bonds and 14.8 Bn in sukuks.* ***Furthermore, bond/sukuk maturities this year stands at USD 38.7 Bn for the GCC issuers. Combined this with estimated deficits of more than USD 150 Bn for the year, fixed income issuances could overtake last year's levels in 2020.***





Sources : Bloomberg, Kamco Invest Research

Junaid Ansari
Vice President
+(965) 2233 6912
jansari@kamcoinvest.com

Rating actions

The pandemic has resulted in almost 36 sovereign downgrades by the three rating agencies and numerous corporate downgrades, thus raising the cost of funding. However, an analysis from Fitch rating shows that despite the record number of sovereign downgrades, the number of debts that were downgraded were not at a historically high volume. The agency downgraded 22 sovereigns which forms 18% of its portfolio but the dollar value of debt that was affected due to the downgraded accounted for around 10% or USD 7.4 Trillion of global government debt outstanding. This was because of the higher number of lower-rated emerging markets being downgraded as compared to developed markets.

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	CBO Repo Rate	Fed Fund Rate
Dec-17	2.75	1.75	2.00	3.50	2.50	2.06	1.25 - 1.5
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
18-May-20	1.50	0.75	1.00	2.25	1.00	0.50	0 - 0.25
1-Yr Change (%)	-1.50	-2.00	-2.00	-2.25	-1.50	-2.43	-2.25
2-Yr Change (%)	-1.50	-1.25	-1.25	-1.50	-1.50	-1.98	-1.5

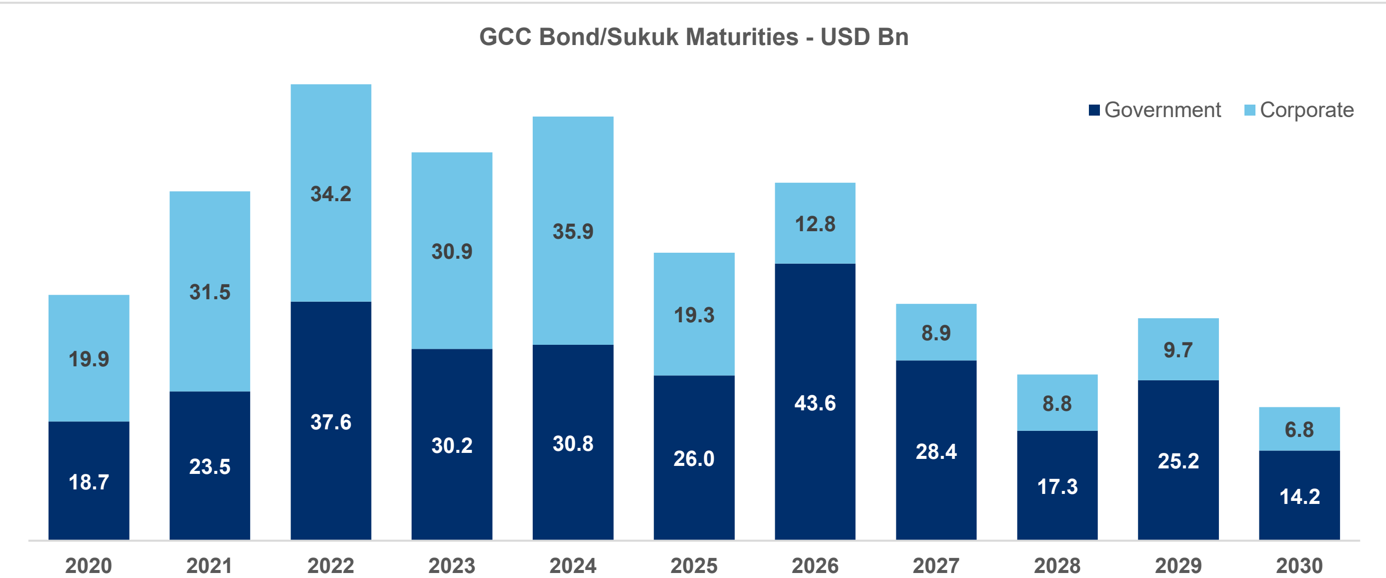
GCC - Sovereign Credit Ratings Profile						
	S&P		Moody's		Fitch	
	Rating	Outlook	Rating	Outlook	Rating	Outlook
Bahrain	B+	STABLE	B2u	STABLE	BB-	STABLE
Kuwait	AA-	STABLE	Aa2	Under Review	AA	STABLE
Oman	BB-	NEG	Ba2	Under Review	BB	NEG
Qatar	AA-	STABLE	Aa3	STABLE	AA-	STABLE
Saudi Arabia	A-u	STABLE	A1	NEG	A	STABLE
UAE	NR	NR	Aa2	STABLE	NR	NR
Abu Dhabi	AA	STABLE	Aa2	STABLE	AA	STABLE

Sources : Bloomberg, Kamco Invest Research

In terms of ratings action in the GCC, YTD-2020 downgrades included that of Kuwait and Oman by one notch by S&P triggered by fiscal pressure due to the fall in oil prices as these countries heavily depend on oil revenues to meet their budgeted spending. The downgrade was based on an oil price expectation of USD 30/d for 2020 which we believe is too low and does not take into account the expected demand revival during the second half of the year. In addition, with one of the lowest debt-to-GDP ratio and faring largely better than its neighbors in other metrics like external debt and fiscal balance, Kuwait is least vulnerable to the current pressure on the economic front. In case of Saudi Arabia, public debt is low at 23% of GDP in 2019 as compared to the average emerging market 53%. However, the ratio have been rising in recent years and with the additional spending related to Covid-19, budget deficits are expected to widen and debt ratios expected to worsen.

Bond/Sukuk Maturities

GCC governments are seeing USD 140.9 Bn in fixed income maturities over the next five years whereas corporate maturities stand at USD 152.4 Bn. A majority of these maturities are in USD followed by local currency issuances in SAR and QAR. 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 almost USD 200 Bn in maturities over the next five year whereas sukuk maturities are expected to increase starting from 2022.



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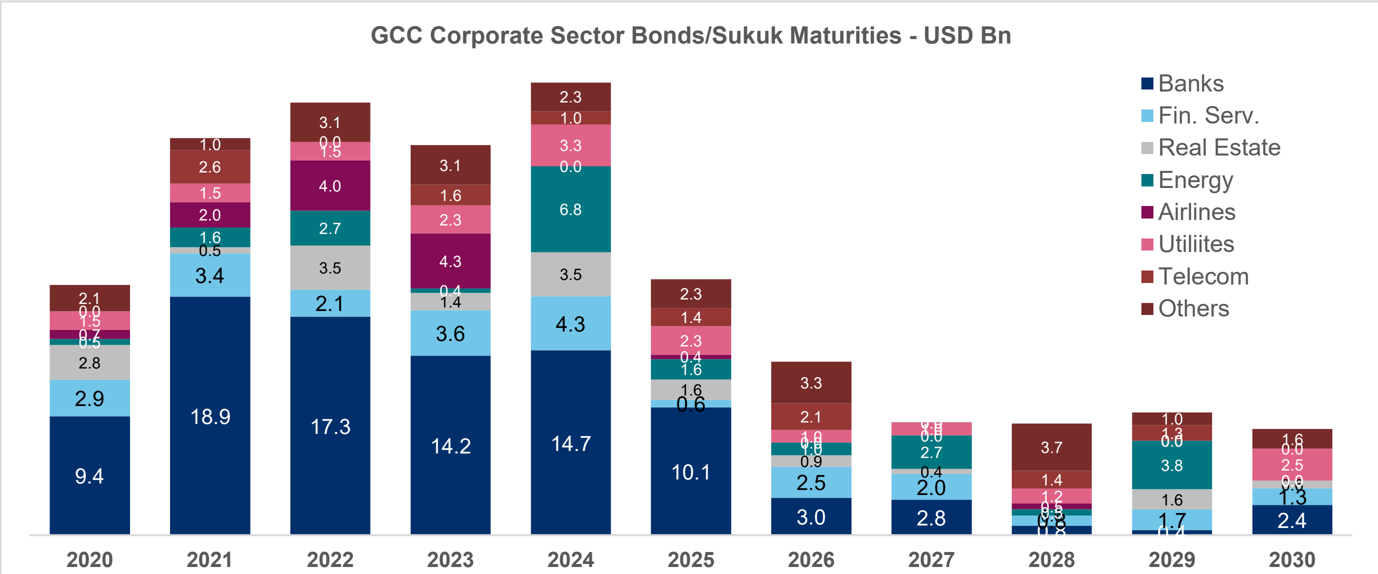


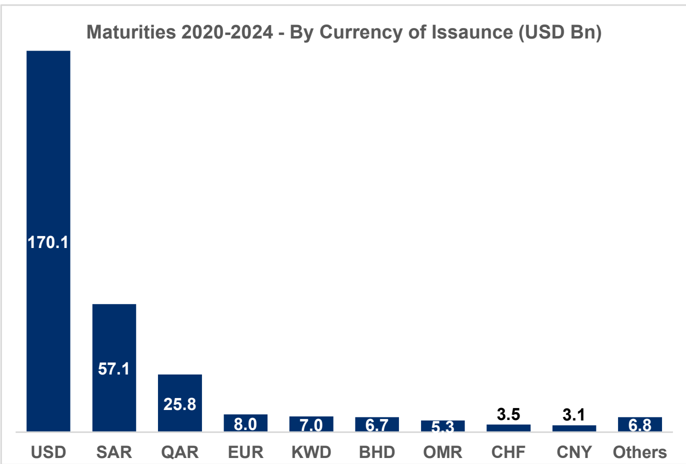
Sources : Bloomberg, Kamco Invest Research

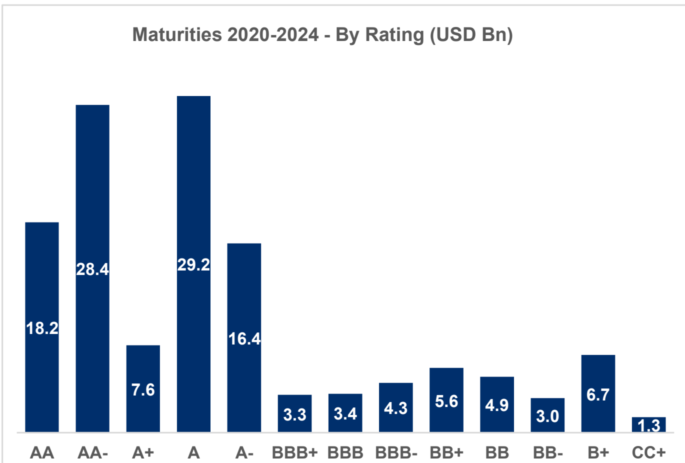
In terms of sector maturities, Banks and other Financial Services sector have USD 91 Bn in maturities in the next five years, accounting for around 31% of the total outstanding until 2024. The Energy and Real Estate sector maturities were next at USD 12 Bn each or a total 8% of total maturities until 2024. Banks in UAE have the biggest maturities over the next five years at USD 45 Bn followed by Qatar at USD 20.8 Bn, totaling 22.4% of total bond/sukuk maturities over the next five years in the GCC. Real Estate maturities are also concentrated in UAE and Qatar at USD 5.9 Bn and USD 3.5 Bn, respectively, until 2024.

These issuances were aimed at both new funding needs as well as refinancing needs. GCC bonds and sukuk refinancing stands at close to USD 300 Bn in the next five years, and out of this nearly two third are bonds and the remaining one third or USD 95.1 Bn are maturities of sukuks. In terms of country split, UAE has the biggest upcoming maturities at USD 94.1 Bn followed by Saudi Arabia and Qatari government and corporates at USD 87.1 Bn and USD 67.0 Bn. Loan maturities in the GCC region is also almost at the same level over the next five years as bonds and sukuk at USD 302.9 Bn. Around USD 72 Bn in loans are due in the rest of 2020 with UAE companies owing around 46% or USD 32.8 Bn by the end of 2020.

Outlook

We expect GCC bond and sukuk issuances to once again grow this year backed both budget refinancing needs, as well as new funding requirements. The onset of the Covid-19 has resulted in additional needs for both corporate and government entities which should support primary market issuances for the rest of the year and in the near term. In addition, with four out of the six GCC countries having comfortable investment grade ratings and the assumed support from the group to Oman and Bahrain, we believe this should support raising funds in the region as well as internationally. Moreover, the sizable sovereign wealth funds for a majority of the sovereigns in the region support the overall credit ratings profile which supports raising funds without any shortfall. For instance, Abu Dhabi's USD 7 Bn bond earlier this month attracted orders of more than USD 25 Bn.





Sources : Bloomberg, Kamco Invest Research

Borrowers are also keen on raising funds due to the low cost of borrowing globally and yield on sovereign bonds reaching an all time low recently rather than tapping the reserves. This helps the sovereigns as they look to take advantage through investing in bargain deals globally with the steep decline in valuations with their own funds, as well as in getting cheap finance to fund their budgets. Recently, Saudi Arabia's PIF purchased stakes in four oil firms, a cruise operator and agreed a deal for a soccer club.

With the decline in oil prices coupled with the implementation of production cuts, GCC government funding requirements are expected to skyrocket in the near term. Governments have announced measures to raise state revenues like the trebling of VAT to 15% by Saudi Arabia in addition to various other measures like reducing subsidies and allowances, privatizations of state owned entities, and delaying/ prioritizing spending on specific projects. However, these should not be enough the deficit hole for the year which according to Fitch Ratings ranges between 15%-25% for most GCC countries. Saudi Arabia is expected to run deficits for the seventh year in a row with Q1-2020 deficit at USD 9.1 Bn. Saudi Arabia's finance minister pointed that the Kingdom may borrow around USD 60 Bn this year to budget deficits. According to reports, Saudi Arabia, Kuwait and Oman can see a total budget deficit of around USD 141 Bn this fiscal year. This, coupled with GCC bond/sukuk maturities of almost USD 40 Bn this year, should see fixed income issuances far surpass last year's issuances that totaled USD 140 Bn.

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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 : kamcoird@kamcoinvest.com
Website : www.kamcoinvest.com