Emirates NBD

Credit Weekly
10 September 2018

GCC Credit Monitor

Stronger than expected economic data out of the US continued to defy fears of the negative impact of the stronger dollar or the trade wars on the US economy, thereby boosting the case for continued rate hikes in the US. UST Yield curve shifted upward with yields on 2yr, 5yr, 10yr and 30yr UST closing the week at 2.70% (+8bps w/w), 2.82% (+8bps, w/w) and 2.94% (+8bps, w/w) and 3.10% (+8bps, w/w) respectively. Yields on sovereign bonds rose across the Atlantic in sympathy with the USTs with 10yr Bund and Gilt yields closing the week higher at 0.39% (+6bps, w/w) and 1.46% (+5bps, w/w) respectively.

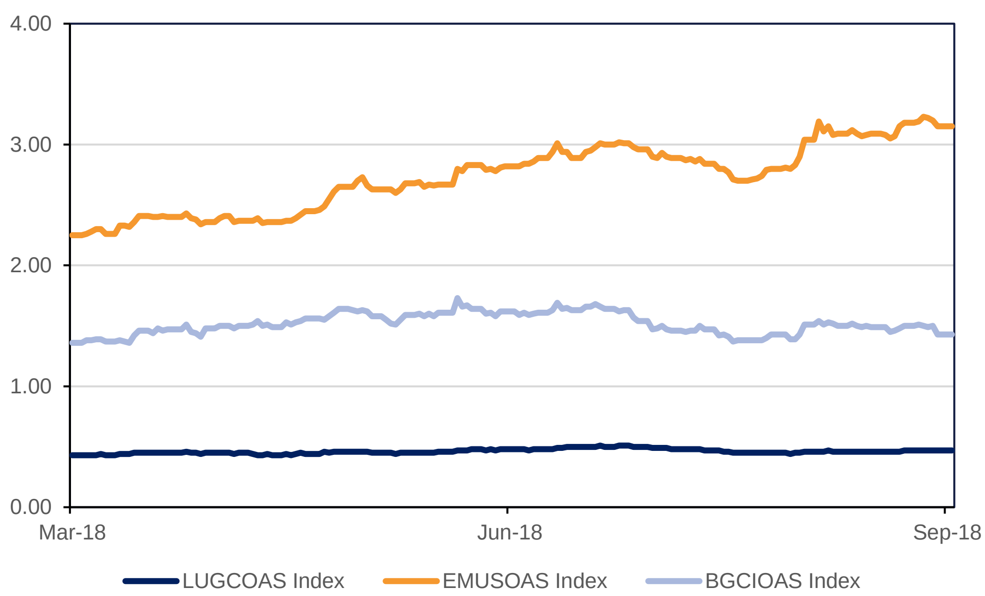
Though risk appetite in the developed world remained intact with CDS levels on US IG and Euro Main remaining stable at around 60bps and 64bps respectively, credit spreads on emerging market bonds maintained their widening bias against the backdrop of strengthening dollar and falling EM currencies. Option adjusted spreads on Barclays EM bond index have risen more than 50% in the recent months to 315bps from 212bps at the beginning of February, somewhat mirroring the circa 15% decline in the JP Morgan EM currency index. In contrast, credit spreads on US Agg index have remained range-bound over the last six months at around 42bps.

Despite the wide spread sell off in EM assets, GCC bonds are benefiting from rising oil prices, improving economic conditions and thinning new issue pipeline. Credit spreads on Barclays GCC bond index tightened 4bps over the week to 168bps, however, rising benchmark yield saw average yield on Barclays GCC bond index to close higher at 4.46% (+3bps, w/w).

On a generalized basis, the rising oil prices are boosting credit profiles of GCC sovereigns and GREs and this in turn is helping to reduce credit rating downgrades. However, owing to possibly higher borrowings by the Dubai government to fund EXPO 2020 related expenses, credit ratings on some of the Dubai Inc entities have come under pressure. S&P last week downgraded the ratings on DEWA and DIFC by one notch to BBB and BBB- respectively, citing the government's weakening ability to provide support if need be. That said, their respective bonds reflected muted reaction to the rating change. Yield on DEWAAE 20s has remained range bound at 3.42% and that on DIFCAE 24s rose only marginally to 4.1%.

Elsewhere, Moody's has withdrawn its B1 rating on Ezdan due to lack of sufficient information.

GCC vs EM IG bonds and US IG bonds – OAS history (%)



Source: Bloomberg, Emirates NBD Research

Anita Yadav
Head of Fixed Income Research
+971 4 230 7630
anitay@emiratesnbd.com

Bahrain credit curve continued to remain in focus with investors awaiting details of the rescue package that its neighbors, KSA, UAE and Kuwait, are working on. With upcoming maturity of Bahrain's, BHRAIN 18s, sukuk of $750 million in November this year, details of the rescue package must emerge soon in order to prevent any fears of technical default by Bahrain. In the interim, Bahrain raised $500 million via sale of 3yr bonds that were privately placed with five banks from UAE and Kuwait at 3yr mid swap + 330bps. Bahrain CDS has moved in a tight range of between 360 – 400bps ever since the three neighbors confirmed plans to support it in late June.

One notable development of late in the regional capital market has been the merger plans announced by Al Hilal, ADCB and Union National Bank. Given their common shareholder, the Abu Dhabi Investment Council that owns 100% of Al Hilal, 62% of ADCB and circa 51% of UNB, the chances of the discussions morphing into reality are reasonably high. Of the three, ADCB is the largest and strongest with circa $72 billion in assets and a credit rating of A1 while Al Hilal is the smallest with assets of around $12 billion and credit rating of A2. The merger, if successful, will likely be positive for Al Hilal and neutral for ADCB and UNB. Yield on ADCB was little changed from its 4.11% mark.

GCC Primary Market

After months of hiatus, primary market finally has few issuers seeking to raise funding. ADIB is on the road with a possible offering of Tier 1, perpetual, non-call five year benchmark sized sukuk and DP World is looking to raise sufficient funds to refinance upcoming maturity of its $750 million of JAFZA 19s. Al Hilal continues to roadshow for a Reg S sukuk and Aldar Properties has also mandated banks for benchmark sized sukuk.

Looking ahead, the full year new issues in 2018 are likely to fall short of original forecast of circa $85 billion as rising oil revenues limit the government's funding needs. KSA is expected to tap its local currency markets for future issuance this year and Oman is unlikely to need additional funding this year. This leaves Kuwait that could come to the market as and when its parliament approves the increase in debt limit and tenure for the government bonds.

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Emirates NBD Research & Treasury Contact List

Emirates NBD Head Office
12thFloor
Baniyas Road, Deira
P.OBox777
Dubai

Jonathan Morris
General Manager Wholesale Banking
JonathanM@emiratesnbd.com

Aazar Ali Khwaja
Senior Executive Vice President
Global Markets & Treasury
+971 4 609 3000
aazark@emiratersnbd.com

Tim Fox
Head of Research &
Chief Economist
+9714 230 7800
timothyf@emiratesnbd.com

Research

Khatija Haque
Head of MENA Research
+9714 230 7803
khatijah@emiratesnbd.com

Anita Yadav
Head of Fixed Income Research
+9714 230 7630
anitay@emiratesnbd.com

Aditya Pugalia
Director, Financial Markets Research
+9714 609 3027
adityap@emiratesnbd.com

Athanasios Tsetsonis
Sector Economist
+9714 230 7629
athanasiost@emiratesnbd.com

Edward Bell
Commodity Analyst
+9714 230 7701
edwardpb@emiratesnbd.com

Daniel Richards
MENA Economist
+9714 609 3032
danielrich@emiratesnbd.com

Mohammed Altajir
FX Analytics and Product Development
+9714 609 3005
mohammedtaj@emiratesnbd.com

Hessa Al Khawaja
Research Associate
+9714 609 3015
Hessaalkh@emiratesnbd.com

Sales & Structuring

Group Head – Treasury Sales
Tariq Chaudhary
+971 4 230 7777
tariqmc@emiratesnbd.com

Saudi Arabia Sales
Numair Attiyah
+966 11 282 5656
numaira@emiratesnbd.com

Singapore Sales
Supriyakumar Sakhalkar
+65 65785 627
supriyakumars@emiratesnbd.com

London Sales
+44 (0) 20 7838 2241
vallancel@emiratesnbd.com

Egypt
Gary Boon
+20 22 726 5040
garyboon@emiratesnbd.com

Emirates NBD Capital

Ahmed Al Qassim
CEO- Emirates NBD Capital
AhmedAQ@emiratesnbd.com

Hitesh Asarpota
Head of Debt Capital Markets.
+971 50 4529515
asarpotah@EmiratesNBD.com

Investor Relations

Patrick Clerkin
+9714 230 7805
patricke@emiratesnbd.com

Group Corporate Affairs

Ibrahim Sowaidan
+9714 609 4113
ibrahims@emiratesnbd.com

Claire Andrea
+9714 609 4143
clairea@emiratesnbd.com