بنك الإمارات دبي الوطني
Emirates NBD

GCC Bonds
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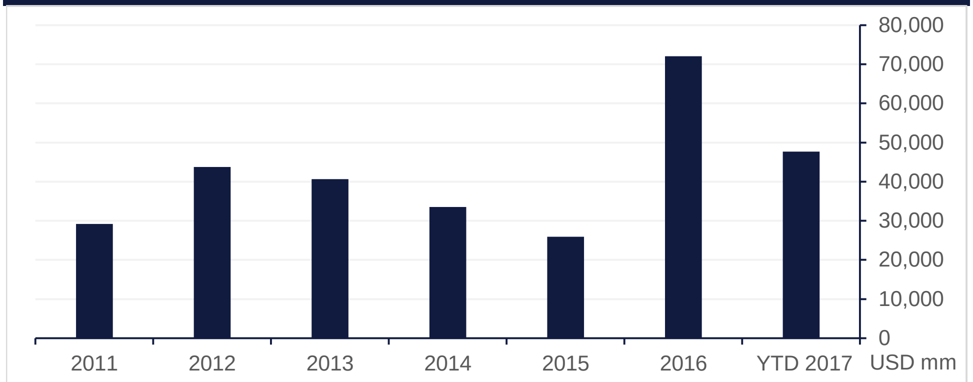
Anita Yadav
Head Fixed Income Research
Tel: +9714 230 7630
anitay@emiratesnbd.com

www.emiratesnbdresearch.com

In Search of New Supply

After record new GCC bond issuance in the first half of 2017, primary market seems to have grinded to a halt in the third quarter. In H1 2017, Governments of the six GCC nations issued an unprecedented amount of bonds to cover budget deficits caused by low oil prices. Large deals such as the $9 billion sukuk from Saudi Arabia, $8 billion bond from Kuwait and $5 billion debt raising by the Oman government lead total issuance to reach a record $43 billion in the first half this year compared with $36 billion in the year before.

GCC USD Bonds – New Supply



Source: Bloomberg, Emirates NBD Research.

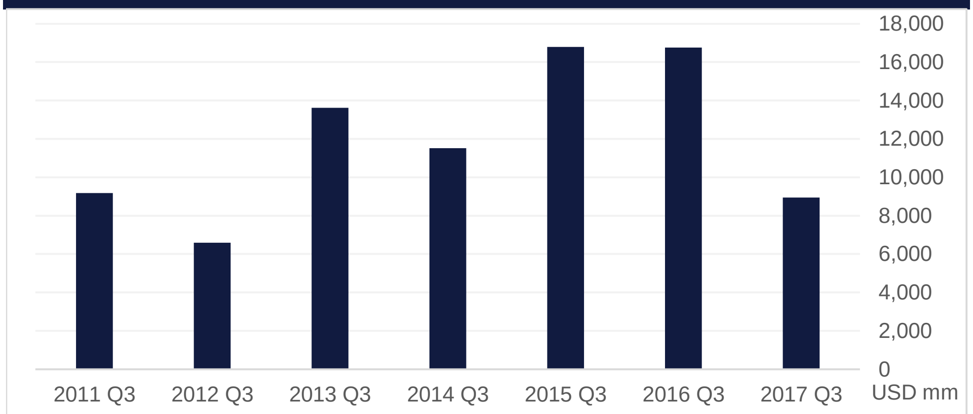
The demand for USD bonds remains high in the region, driven by relatively still low interest rates, the hunt for higher yields and demand for duration by the insurance/pension companies. Improving liquidity in the banking sector also supported bid tone. This made the GCC Bonds deliver solid performance with YTD return on Barclays GCC bond index at 5.5%. This rally is further being lifted by the recent change in the US rate hike expectations driven by increasing geopolitical tensions. However despite good demand and solid performance of existing bonds, new issue supply has been negligible in the recent months.

GCC Bonds New supply - 3rd quarter

Period	3Q 2017	3Q 2016	**3Q 2015**	3Q 2014	3Q 2013
Amount (USD mm)	4,633	8,341	3,983	5,763	8,085
#Issues	25	53	19	24	9

There is no evidence of funding pattern shifting from bonds to loans as the total syndicated loans in the region has also declined in the last quarter.

GCC Syndicated Loans - New originations

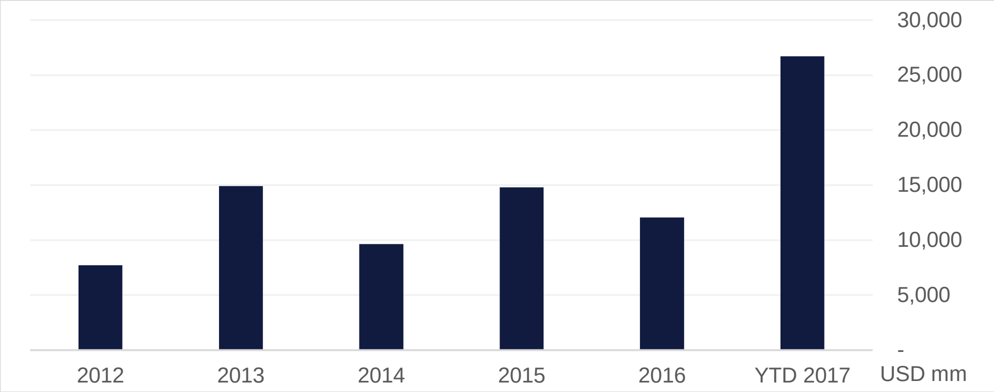


Source: Bloomberg, Emirates NBD Research.

Why USD bond supply is low

a) **Issuance in local currency has increased** : - GCC sovereigns are keen to develop the domestic bond markets to reduce companies' near-complete dependence on bank loans particularly now that governments may not be in a position to fund any cash strapped GRE or large corporate. Consequently, issuance in local currency markets has more than doubled this year, somewhat reducing the need to rely on external funding via USD bonds.

GCC LCY Bonds – New Issues



Source: Bloomberg, Emirates NBD Research.

b) **Corporate funding needs have reduced:-** Slower GDP growth in the region is translating into reduced need for incremental capital expenditure and thereby lower corporate borrowing requirements. Our forecast for average real GDP growth for the GCC block this year is 1.1% which is less than half of 2.3% achieved last year as OPEC members implement oil production cuts. Though we expect GDP growth to pick up next year, it may not translate into any immediate capital expenditure funding need by the corporates. Even in Dubai, the economy most diversified and with low reliance on oil, the difference between the latest 12 month sales growth rate and the most recent five year historical compounded annual growth rate (CAGR) for the corporates is -0.7% (market cap weighted average for DFM listed stocks)

Real GDP growth in GCC

	2015	2016e	2017f	2018f
S. Arabia	4.1	1.7	0.5	2.5
UAE	3.8	3.0	2.0	3.4
Qatar	3.3	2.0	2.5	3.5
Kuwait	1.8	2.1	-1.0	2.2
Oman	5.7	3.7	1.0	2.3
Bahrain	2.9	3.0	2.2	2.4
GCC (average)	**3.8**	**2.3**	**1.1**	**2.8**

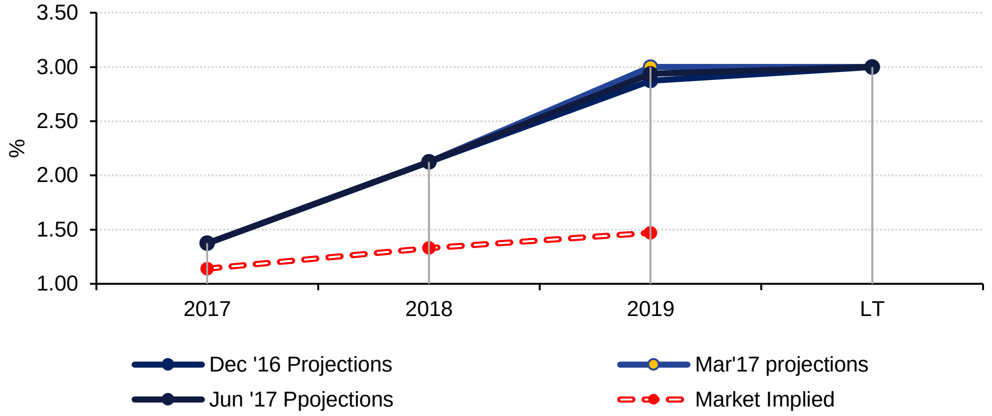
Source: Bloomberg, Emirates NBD Research.

c) **Government budget deficits are reducing**:- At the beginning of this year, the estimate for total budget deficits in 2017 for the six GCC nations was circa $100 billion (vs $150 billion in 2016). The reduction in deficit his year was predicated on the basis of reforms and revenue measures undertaken by the sovereigns. Though KSA and Oman previously had a track record of spending more than the budget, this year the trend seem to have reversed. Information on YTD budget performance actually has surprised on the positive side, particularly for KSA where deficits for the 1H 2017 is lower than budgeted. Lower budget deficits means lower need for external debt.

d) **First Ramadan, then the summer lull and now the slippery confidence :-** We expected new issue supply to pick up in mid-August, after the Ramadan and summer holidays induced lull in the previous three months. However, this got hijacked by the increasing volatility and risk aversion in financial markets on the back of geopolitical tension due to North Korea's missile testing. Average credit spread on Barclays Bloomberg GCC credit index have risen circa 15bps in the recent past from 123bps in end May to 140bps now. Issuers are wary of approaching investors at such time for the fear of having to pay heavily or worse, not be successful in completing the deal at all.

e) **Lower rate hike expectations has reduced the urge to front load borrowing needs:** - At the beginning of this year, market expectations for rate hikes in the US were cemented at much higher levels than now. Investors were expecting three to four rate hikes this year followed by similar moves in 2018. In a fast rising rate environment, it was logical for governments and corporates to endeavour to complete their funding ahead of rate hikes. This lead to the big issuing spree in the second quarter this year. However, since then, rising geopolitical risks, mixed US economic data and changes in US Federal Reserve Board members have reduced the rate hike expectations to only one more hike between now and end of 2018. In fact wavering inflation data is gradually draining confidence out of the belief to raise rates at all. In such environment, no one appears to be in a hurry to face the market volatility.

Increasing divergence between markets and the FED



Source: Bloomberg, Emirates NBD Research.

Future Pipeline

We expect supply to pick up in the coming months as seasonality wanes and as issuers get pushed to complete their funding needs before the year end. There is $4.5 billion coming up for redemption between now and end of the year, part of which, particularly the maturities relating to QIB, QIIB, FGB and TAQA could get refinanced. Below issuers have either already announced or stated plans to tap the market in near future:

- Qatar National Bank, Doha Bank and CBQ have announced intention to tap international investors to boost coffers ahead of any pressure on funding from withdrawal of GCC deposits.
- Bahrain government is already road-showing for potential 7yr, 12yr and 30yr offerings.
- Oman government is believed to have mandated banks for an international bond.
- SECO is in talks with banks for USD sukuk
- Aramco, that raised money in the SAR domestic market earlier this year, still has plans to raise funds via USD bond/sukuk.
- Union Properties, the developer of Motor City in Dubai, could potentially tap the market before the end of this year for up to $2 billion.
- TAQA is likely to approach investors to refinance upcoming bond maturity.

In consideration of a bigger decline in GDP growth in the region than expected early in the year, we expect total new supply of bonds for the whole year to finish at circa $65 billion.

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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
Group Treasurer & EVP 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

Shady Shaher Elborno
Head of Macro Strategy
+9714 2012300
shadyb@emiratesnbd.com

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

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

Mohammed Al-Tajir
Manager, FX Analytics and Product Development
+9714 609 3005
mohammedtaj@emiratesnbd.com

Aditya Pugalia
Analyst
+9714 230 7802
adityap@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