# GCC Bonds 2018 Performance

January 2019

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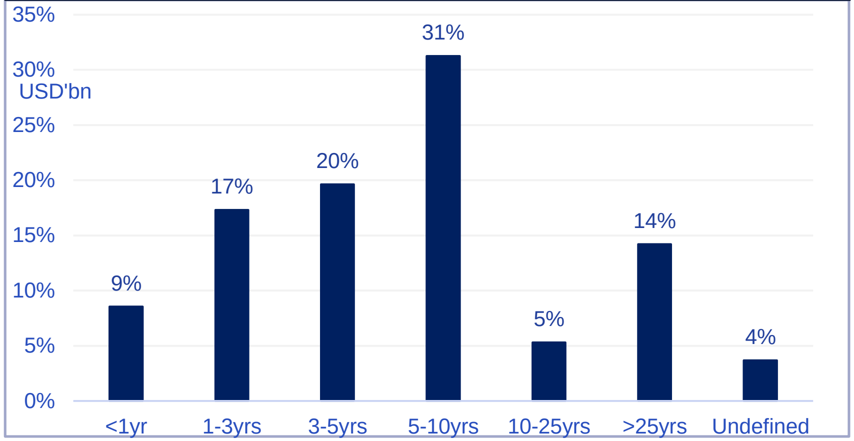
# GCC Fixed Rate USD Bond Universe

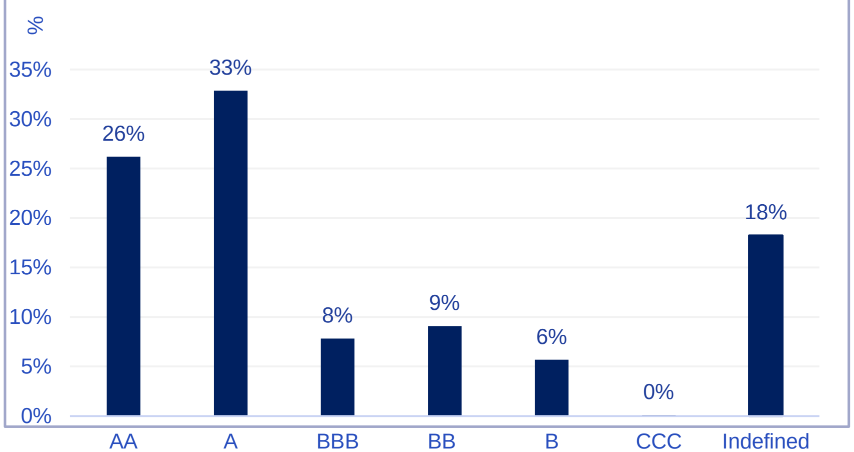
### Highlights

- Total outstanding in the GCC fixed rate USD bond universe is circa $300 billion which has increased from around $180 billion in 2014
- About 46% of outstanding bonds mature in less than five years and 77% in less than 10 years. Circa one fourth (22%) of the total is in sukuk format.
- Over two thirds are investment grade rated (assuming Dubai Inc in the BBB range).
- UAE, Qatar and Saudi account for 40%, 18% and 21% of the total market respectively with Bahrain only taking 6%.

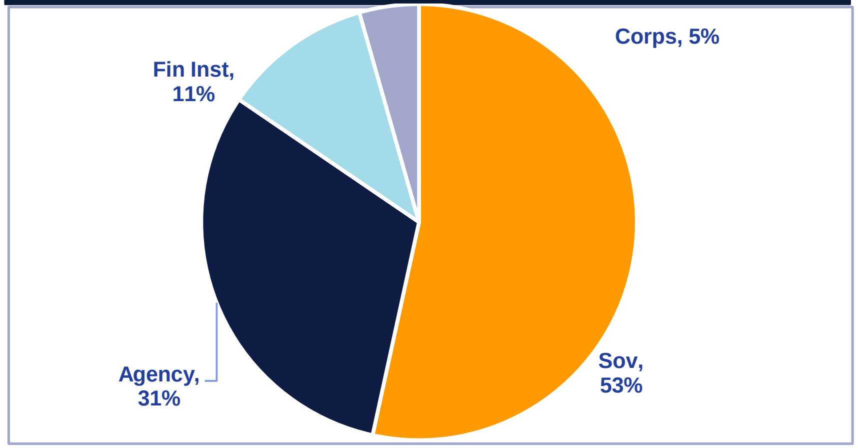
### GCC Universe Maturity Profile




### Credit Rating Breakup




### Sector Breakup




*Source: Bloomberg, Emirates NBD Research*

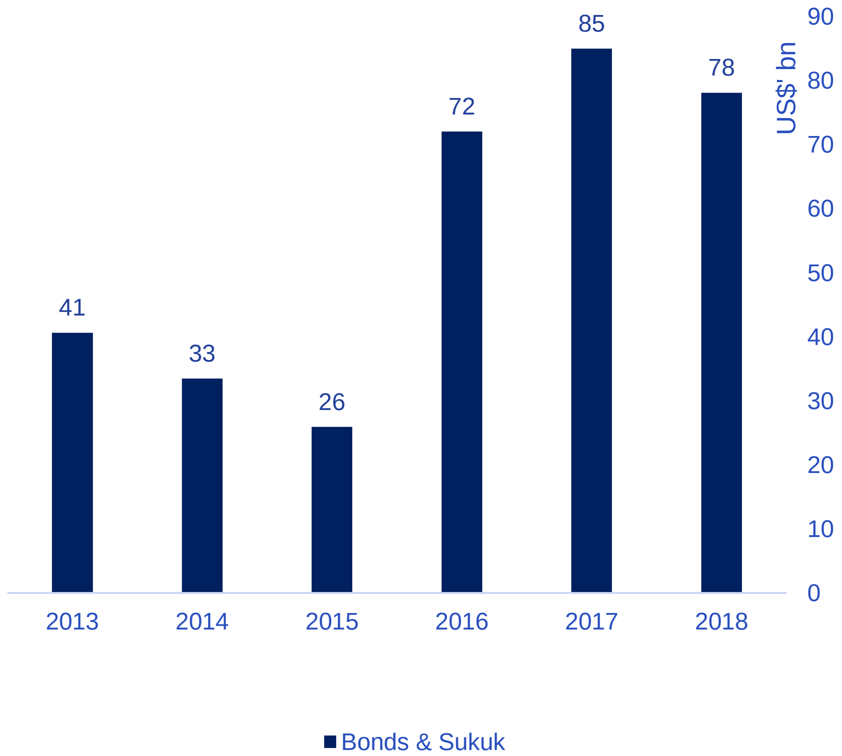
# 2018 Key developments

- Active primary market. New issues exceed $78 billion.
- Smaller government budget deficits in 2018 lowered the issuance from sovereigns to $36 billion in 2018 compared with $51 billion in 2017.
- Sukuk issues lacked momentum with only $18 billion in new sukuk in 2018 vs $22 billion in 2017.
- Technical bid from inclusion in the JP Morgan EMBI index.
- Improved sector diversification.
- Rising security tenures.
- Growth in local currency markets.
- New Debt law in the UAE.
- Credit ratings downgrade saw a hiatus in the first half, however, gained pace again in the second half of 2018 in response to weaker oil prices. Bahrain and Oman sovereigns and sovereign related entities were downgraded by various ratings agencies in the last quarter.
- Resolution of Bahrain's stretched financials.
- Resolution of Dana Gas sukuk default.

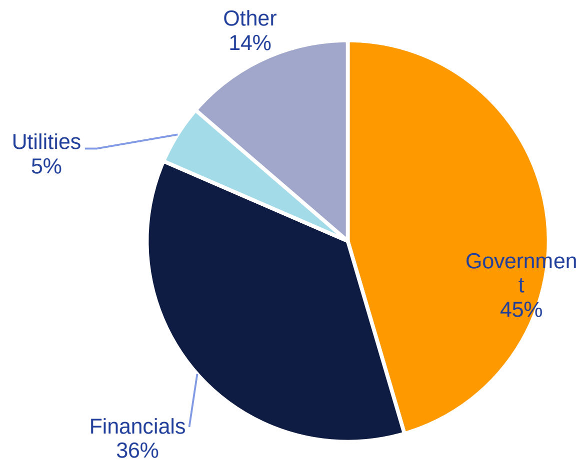
# Strong Primary Market

Despite oil prices averaging higher (and consequently government budget deficits being lower) in 2018 vs 2017, new issue volume was robust due to several new corporates tapping the bond market in 2018.

## 2018 New Supply of USD bonds/sukuk




## Government issuance slowed in 2018



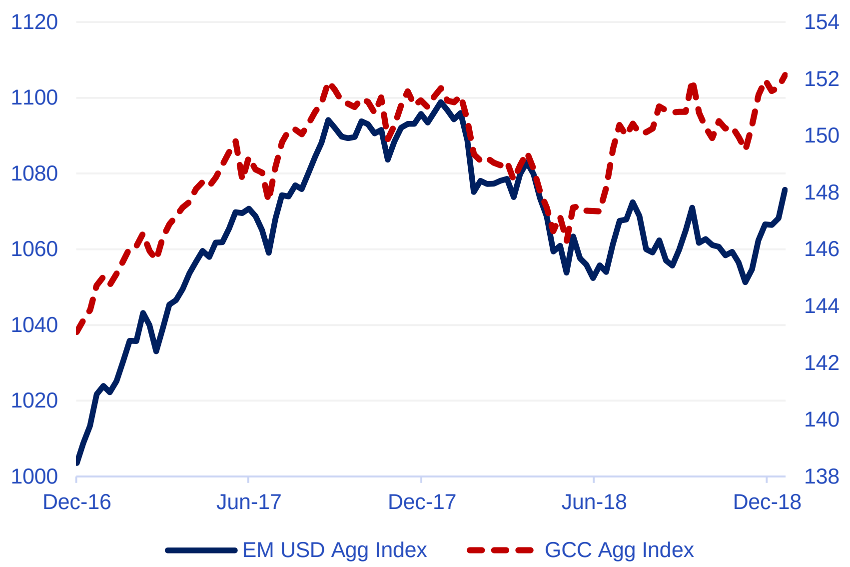

Source: Bloomberg

# GCC outperformed emerging markets in 2018

- GCC bonds outperformed their international peers in 2018 mainly as a result of rising oil prices for most of the year and inclusion in the JP Morgan's EMBI index which ensued strong technical bid for government and quasi government bonds.
- Option adjusted spreads on GCC index bonds increased 57bps to 212bps compared with 60bps widening in credit spreads on US Corps to 153bps and 117bps widening in credits spreads on emerging market USD denominated bonds to 343bps.

Total return on GCC bonds vs US IG Corp bond index

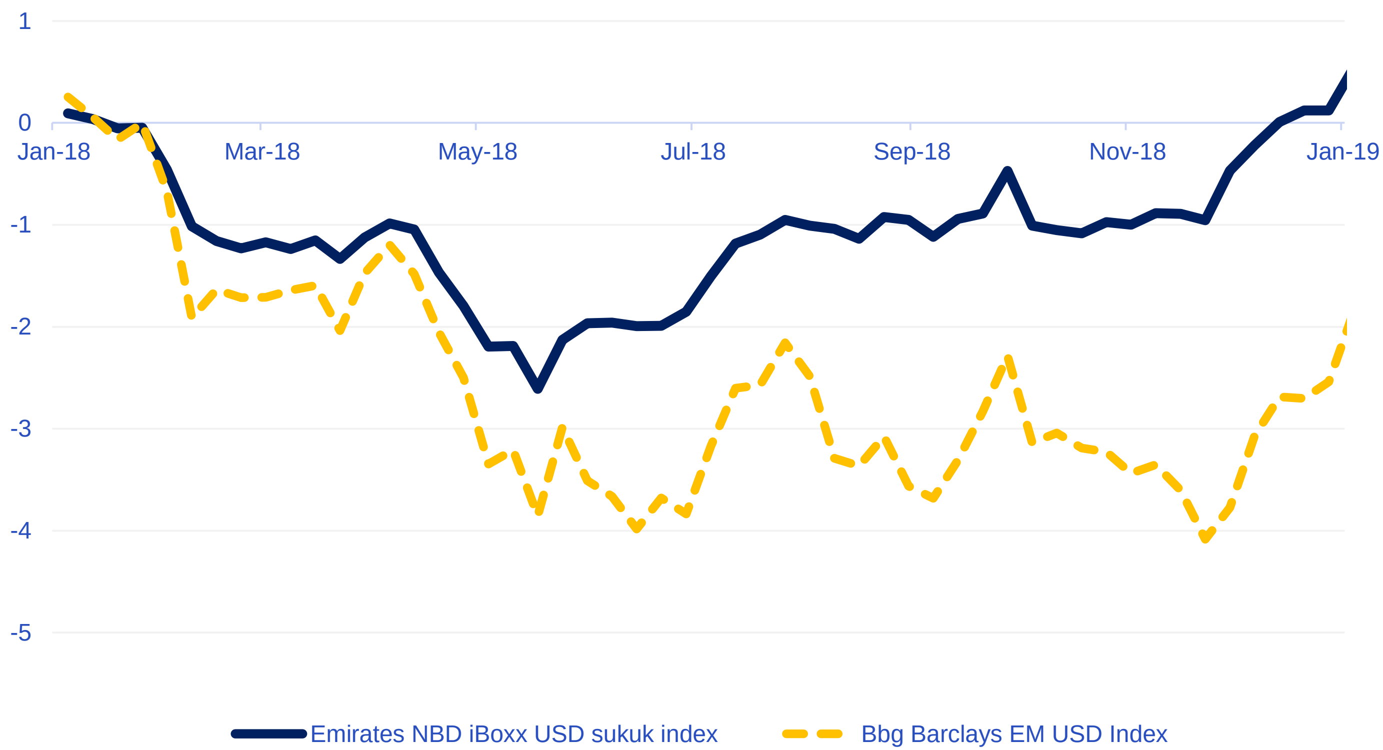

Total return on GCC bonds vs Emerging Market USD bond index




Source: Bloomberg

# Sukuk outperformed conventional bonds

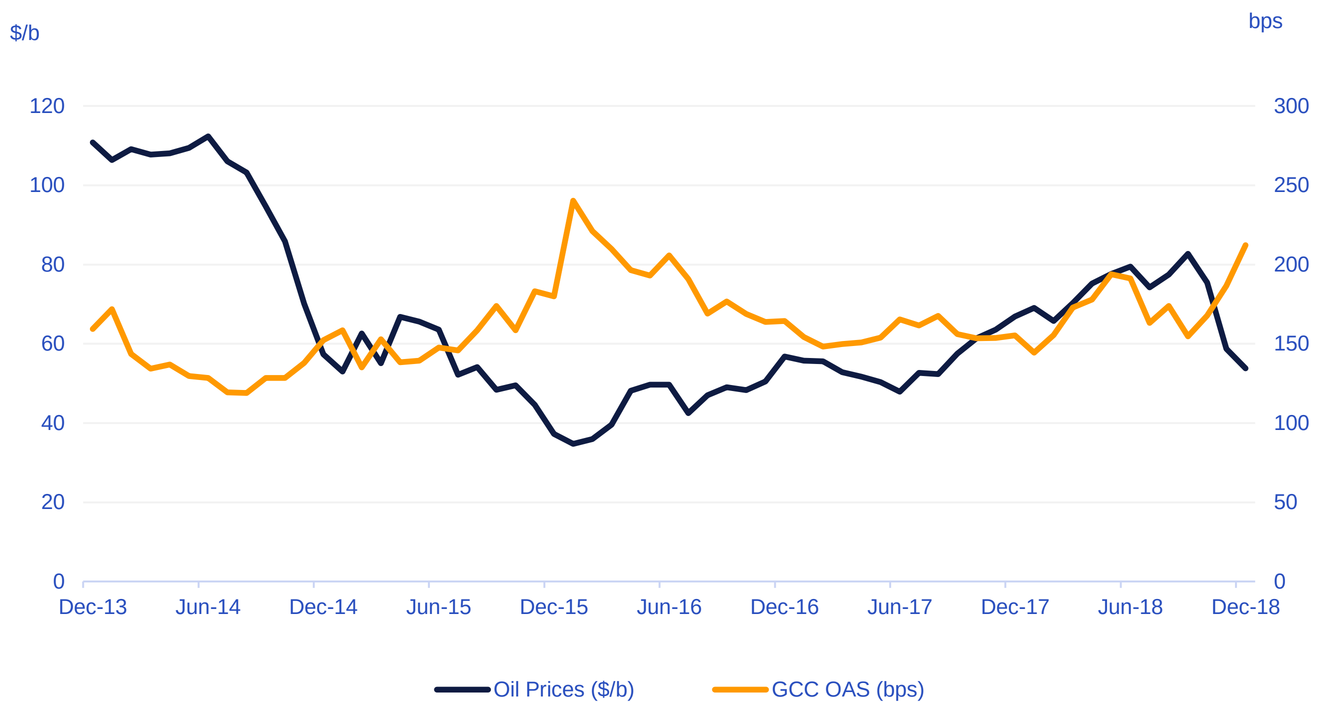
- Even though international sukuk did not remain unscathed amid general sell off in EM assets last year, they did noticeably outperformed their conventional bond counterparts.
- Total return on Emirates NBD Markit iBoxx sukuk index was a small gain of +0.26% last year compared with a loss of -2.5% on EM bond index.




Source: Bloomberg, Emirates NBD

# GCC spreads vs oil prices

- The relationship between GCC bond spreads vs the oil prices is strong.
- However, it very frequently gets overshadowed by other issues such as political concerns, EM capital flows, movements in the UST benchmark yield curve etc.




Source: Bloomberg

# GCC's reliance on oil

## Reliance on oil remains high

- Though diversification efforts have begin to show some benefits, GCC government revenues remain highly reliant on oil prices.
- With oil price assumptions of around $55/b planned budget deficits in the GCC were expected to be circa $87 billion in 2018. However, actual is likely to have been substantially less given that oil prices averaged higher than $70/b last year.

## 2018 Budget (assuming oil @ $55/b)

| USD'bn | Revenue | Expend. | Deficit | 2018 GDP | Bud Def % of GDP |
|---|---|---|---|---|---|
| Bahrain | 6 | 9 | 3 | 36 | 8% |
| KSA | 209 | 261 | 52 | 730 | 7% |
| Kuwait | 56 | 67 | 10 | 109 | 9% |
| Oman | 25 | 33 | 8 | 80 | 10% |
| Qatar | 48 | 56 | 8 | 178 | 4% |
| UAE | 113 | 119 | 6 | 398 | 2% |
| Total | | | 87 | | |

## Hydrocarbon % of Total GDP

| | 2006 | 2016 |
|---|---|---|
| Bahrain | 22 | 11 |
| Kuwait | 57 | 36 |
| Oman | 46 | 26 |
| Qatar | 47 | 30 |
| KSA | 51 | 25 |
| UAE | 37 | 17 |

## 2018 Fiscal and Curr A/c balance % of GDP

| | Curr A/c | F Budget A/c |
|---|---|---|
| Bahrain | -1.64 | 8% |
| Kuwait | 3.08 | 7% |
| Oman | -4.29 | 9% |
| Qatar | 1.62 | 10% |
| Saudi Arabia | 3.99 | 4% |
| UAE | 4.40 | 2% |

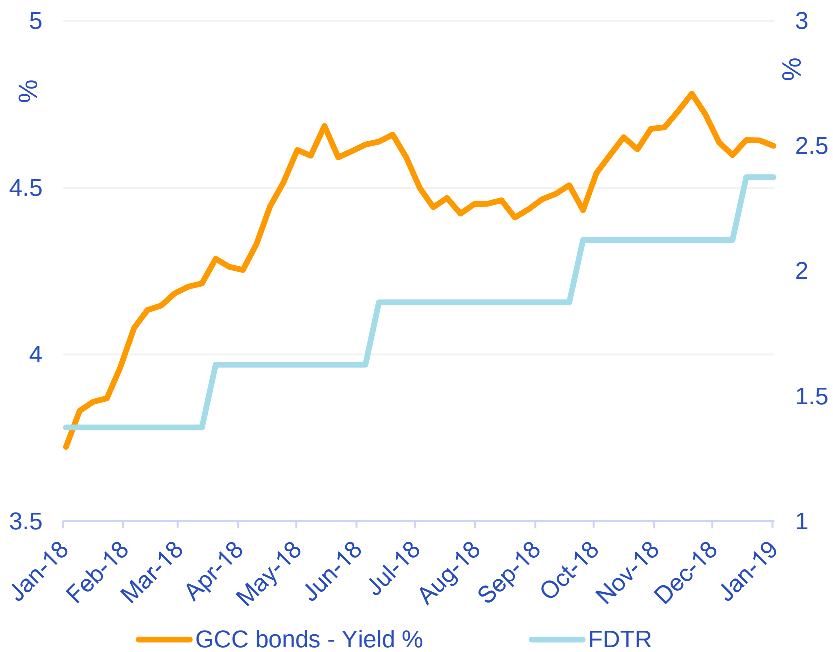
*Source: Bloomberg, Emirates NBD Research*

# GCC bond yields rose in sync with the Fed target rate

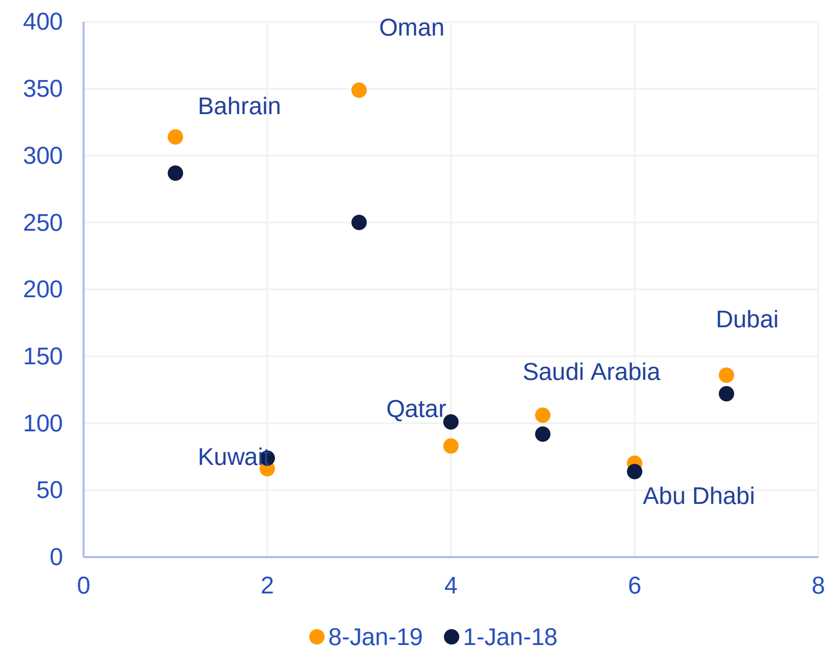
Emirates NBD

- Yield on GCC bonds rose by 92bps to 4.66% in 2018 as Fed raised interest rates by 100bps.
- GCC sovereign CDS spreads generally closed the year at levels higher than where they began in 2018, except for Qatar which benefitted from reducing fears about negative impact on its economy from the diplomatic row with its neighbors.

## Yield on GCC bond index vs FDTR Mid rate




## Sovereign CDS spreads have remained range bound

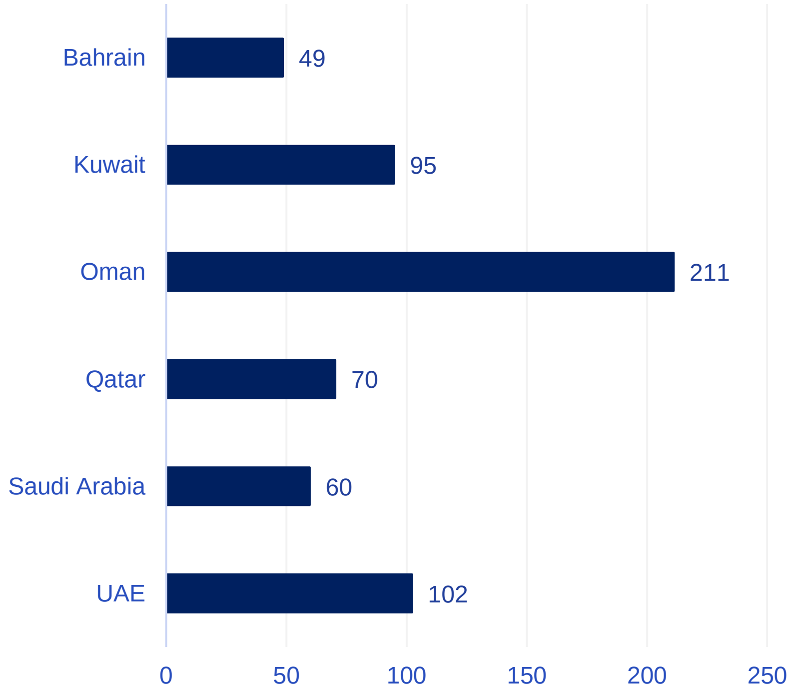



Source: Bloomberg

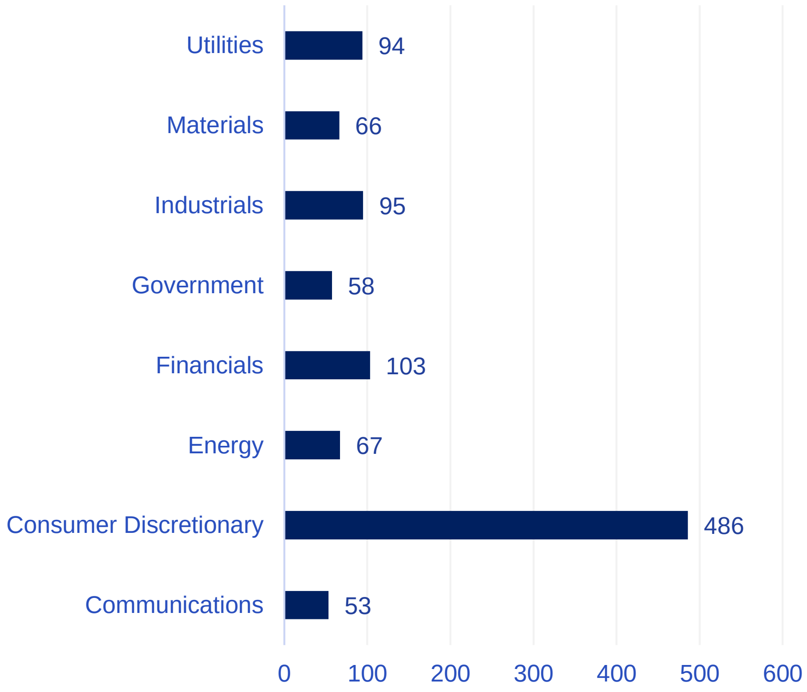
# Sector and country-wise performance

Yield on bonds from Oman increased the most, possibly as a result of the recent downgrade of the sovereign rating and the government's plan to continue funding bulk of their budget deficit via issuance of international bonds. Qatar bonds saw less than average yield widening after rating agencies revised the outlook on Qatar's rating to stable last year, citing satisfactory performance of the economy and its banking system in the face of ongoing political dispute.

## Country-wise Performance – 1yr yield change (bps)




## Sector-wise Performance – 1yr yield change (bps)

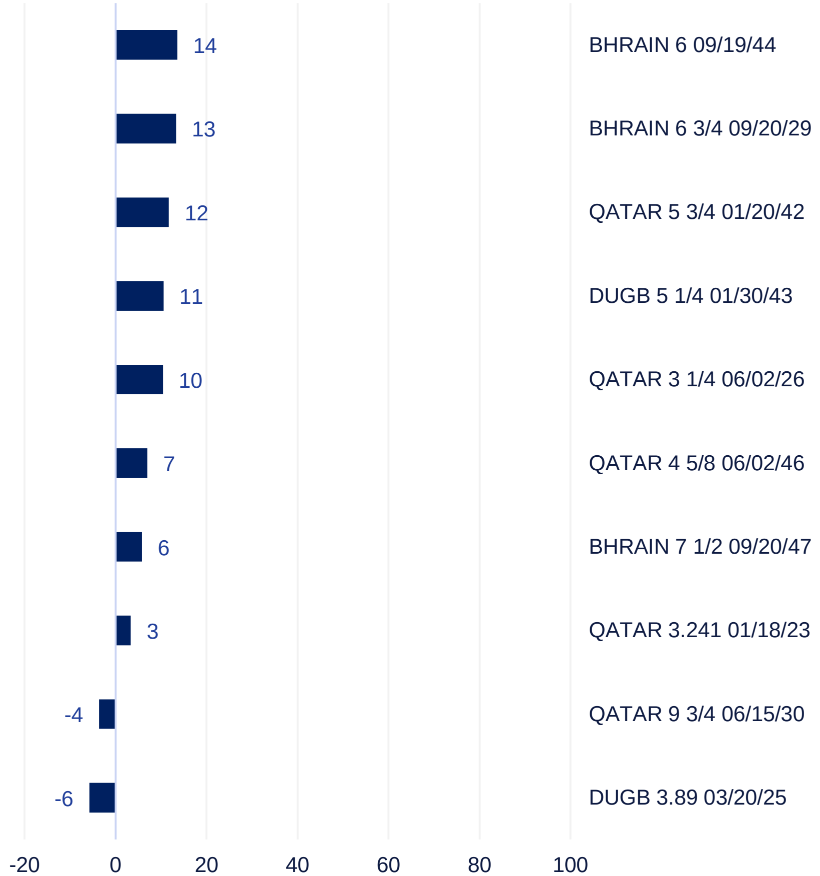



Source: Bloomberg

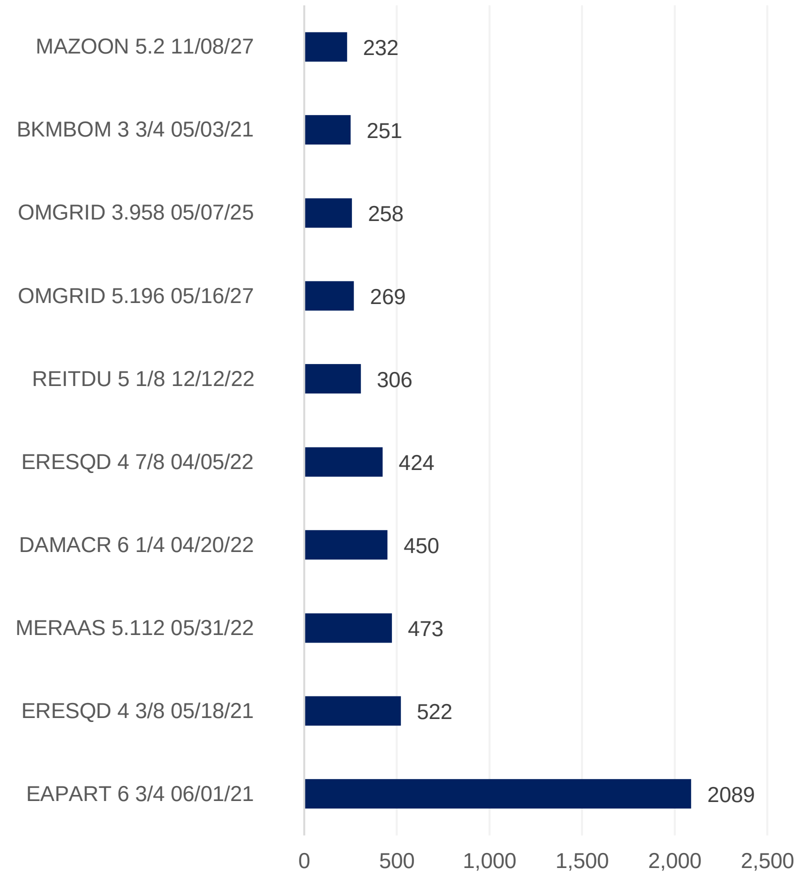
# Top  and Bottom 10 Performers

Shorter dated bonds generally outperform longer tenured ones in a rising interest rate environment.

## Top 10 Performers – 1yr yield change (bps)




## Bottom 10 Performers – 1yr yield change (bps)

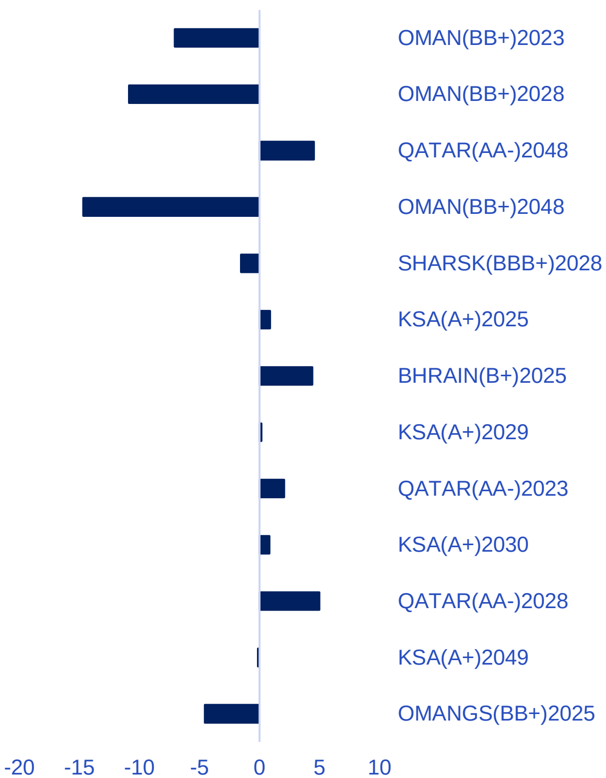



Source: Bloomberg

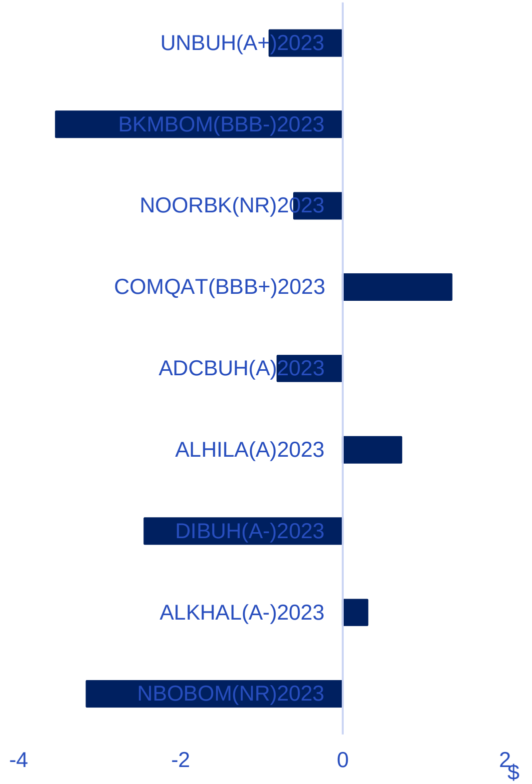
# New Issue Performance

Most new issues lost ground in the secondary market in 2018, however this was more a reflection of rising US interest rate environment rather than any weakness in individual issuers.

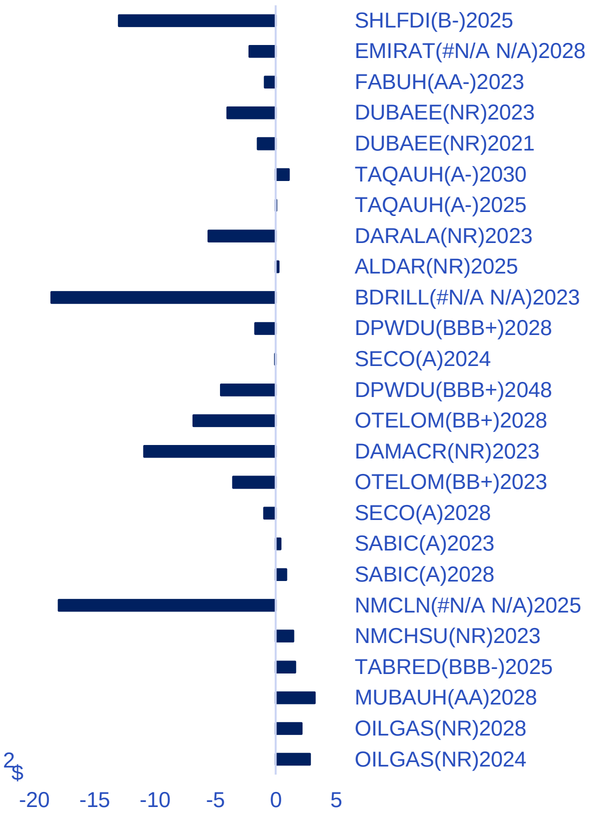
## Sovereigns ($ price chg)




## Financials ($ price chg)



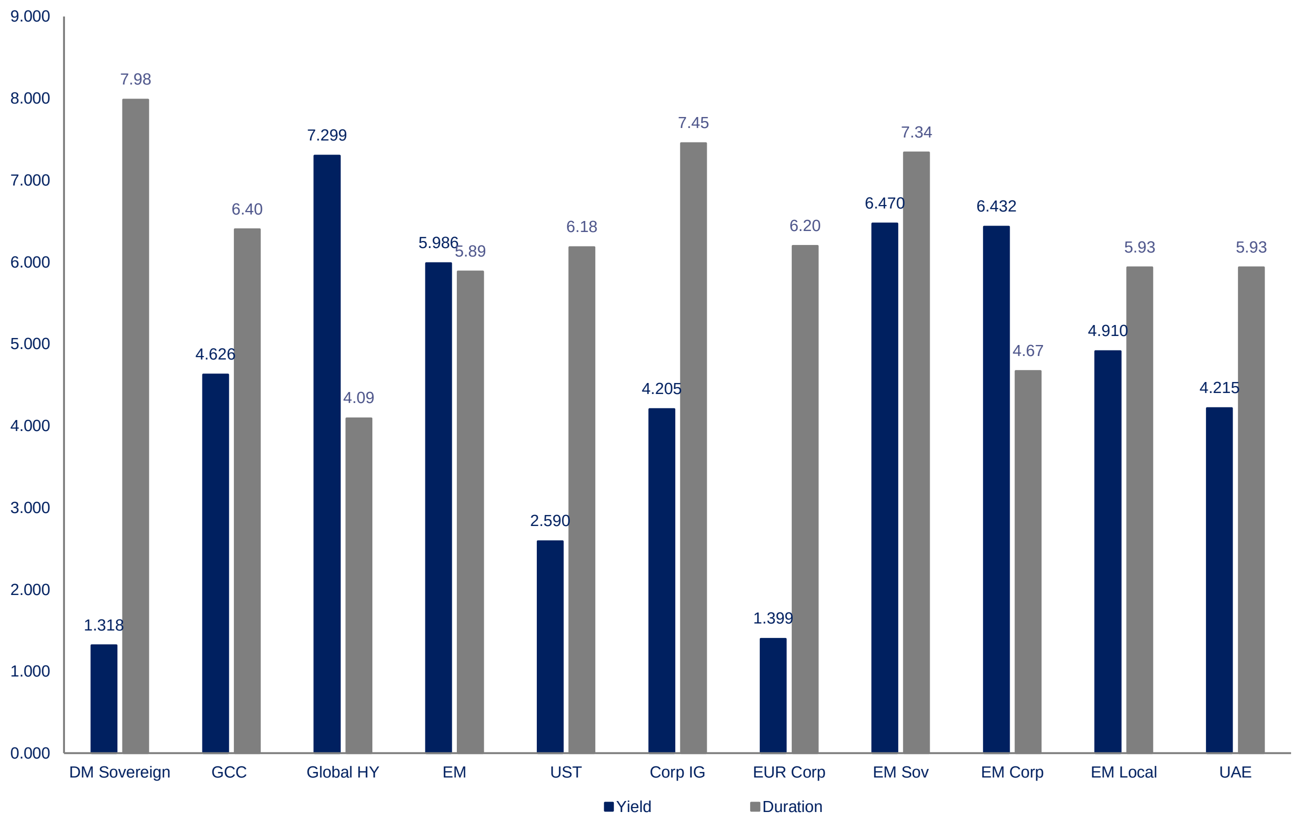

## Corporates ($ price Chg)




Source: Bloomberg

# GCC valuation in perspective

- Duration weighted return on GCC bonds compares favorably with US and European IG corporations.
- Though GCC economies are categorized under the EM universe, they have high per capita income and significantly higher credit ratings than most other EM economies.




Source: Bloomberg

# GCC currently looks attractive on relative value

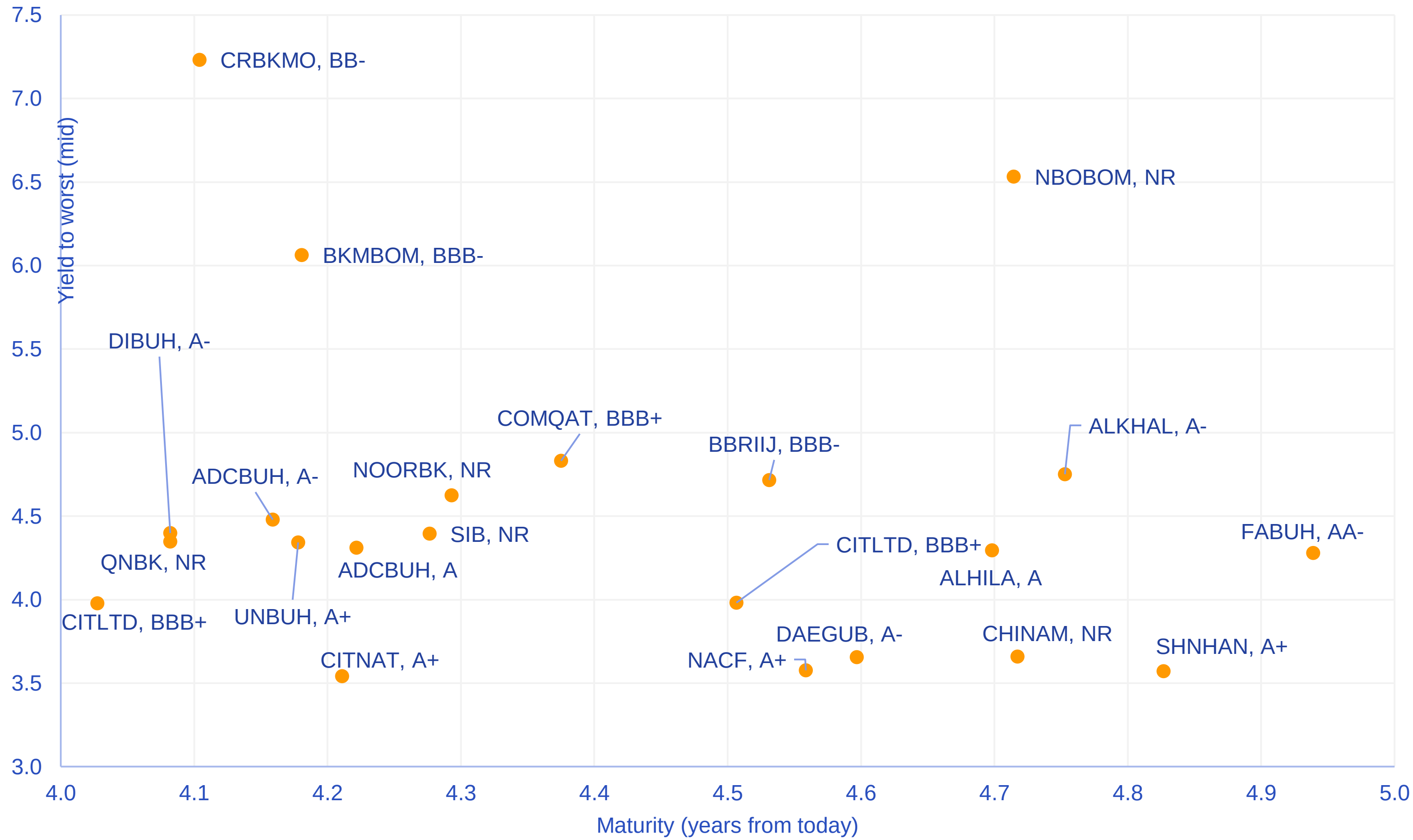
- Running yield on GCC bonds has increased from circa 3.62% last year to 4.60% now reflecting the impact of the four interest rate hikes in the US and consequent increase in the UST yield curve.
- Looking ahead we expect yields to continue rising in line with two more USD rate hikes in 2019. With volatile oil prices we expect higher new issuance and consequently continued pressure on credit spreads.

| | Yield % | OAS bps | YTD Return % |
|---|---|---|---|
| US Agg | 3.26 | 53 | -1.89 |
| Euro Agg | 0.81 | 93 | -1.85 |
| EM US Agg | 5.99 | 338 | -3.67 |
| GCC IG | 4.21 | 160 | -1.06 |
| GCC All | 4.63 | 210 | -0.88 |

Source: Bloomberg

# GCC banks – Relative value

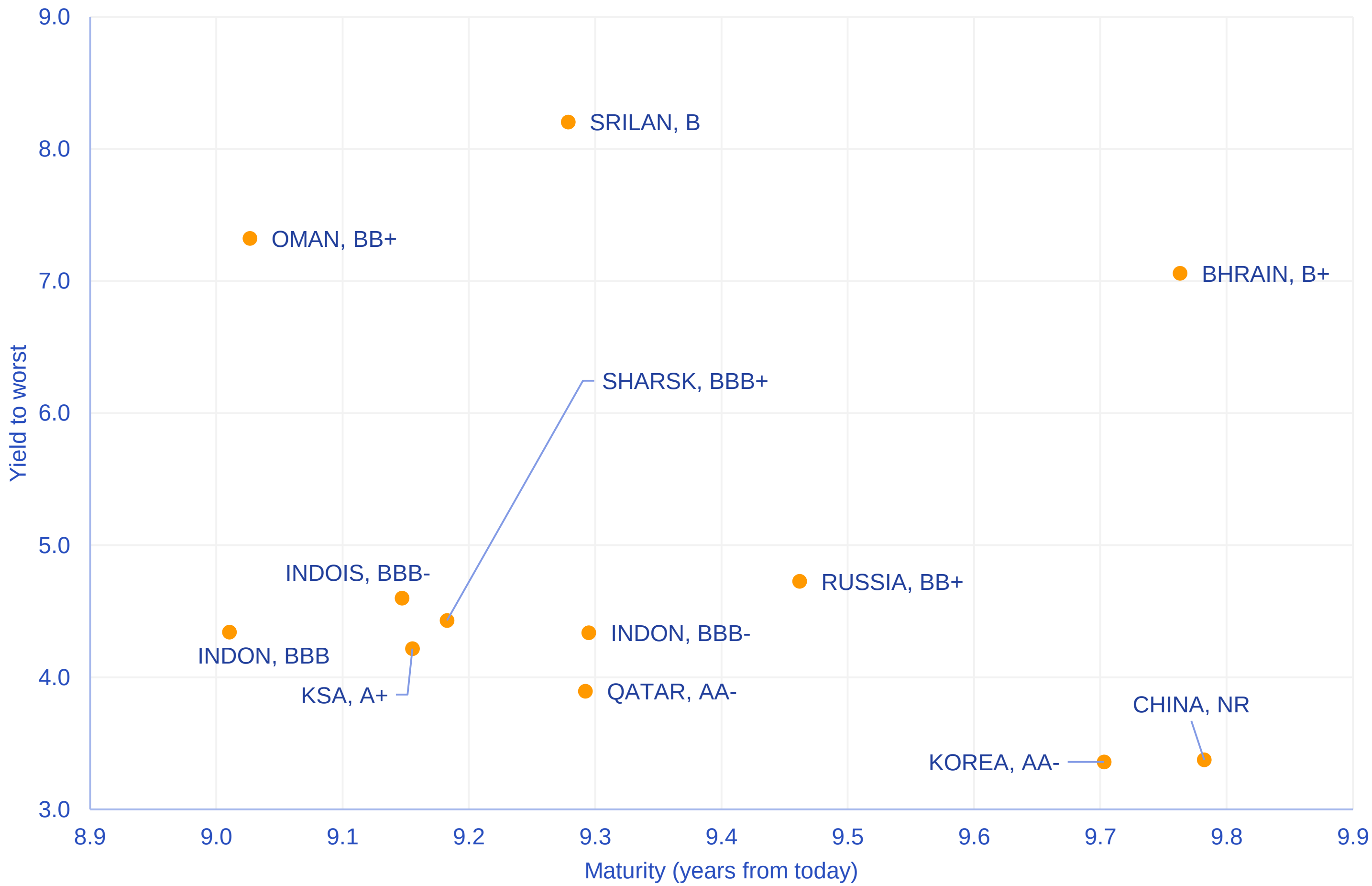
- GCC banks trade cheap relative to their other EM peers.
- ‘A’ category rated GCC banks trade at yields of over 4% compared with similar rated Chinese and Korean banks trading at yield below 4%.




Source: Bloomberg

# GCC sovereigns – Relative value

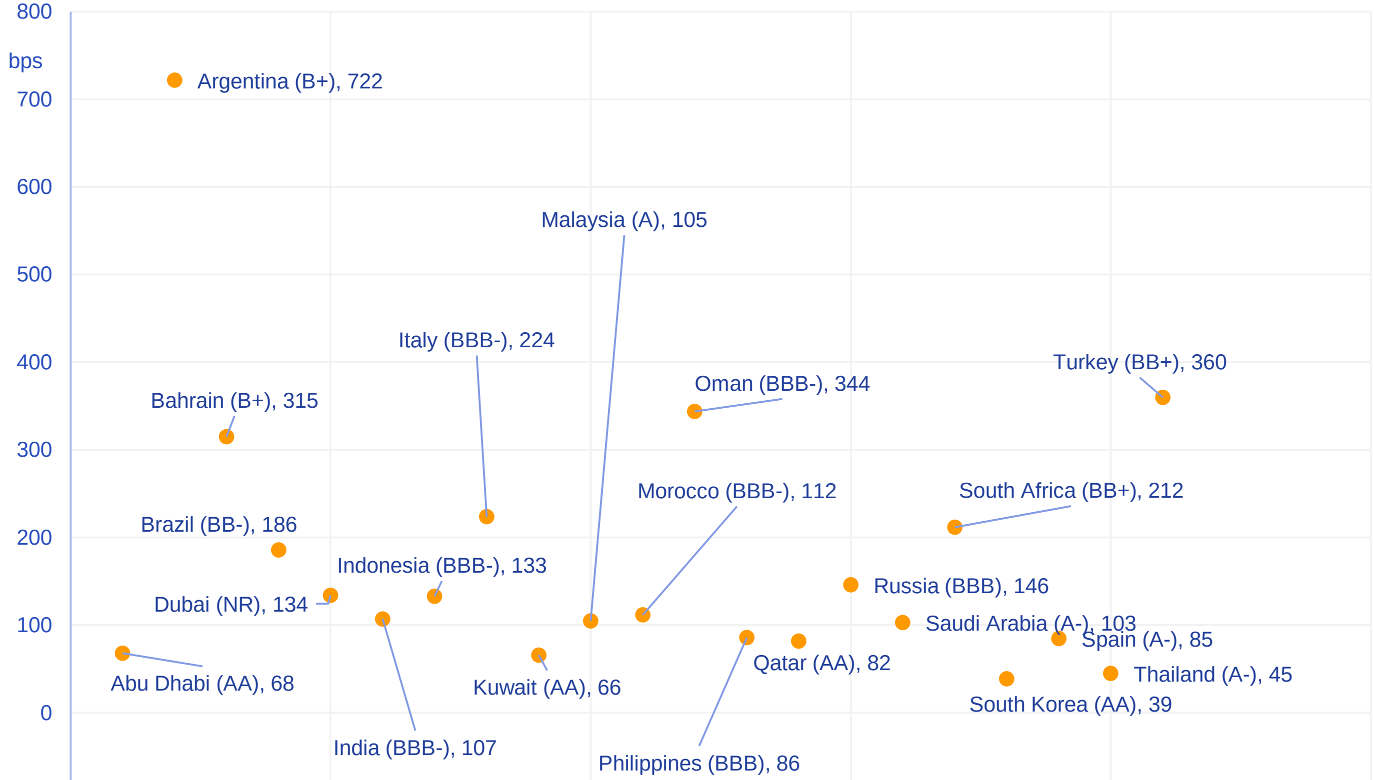
- In view of their higher credit ratings, strong government balance sheets and mostly positive current account surpluses, GCC sovereigns should trade tighter than their emerging market counterparts.
- However current trading levels reflect value discrepancies.




Source: Bloomberg

# GCC sovereigns 5yr CDS spreads – Relative value

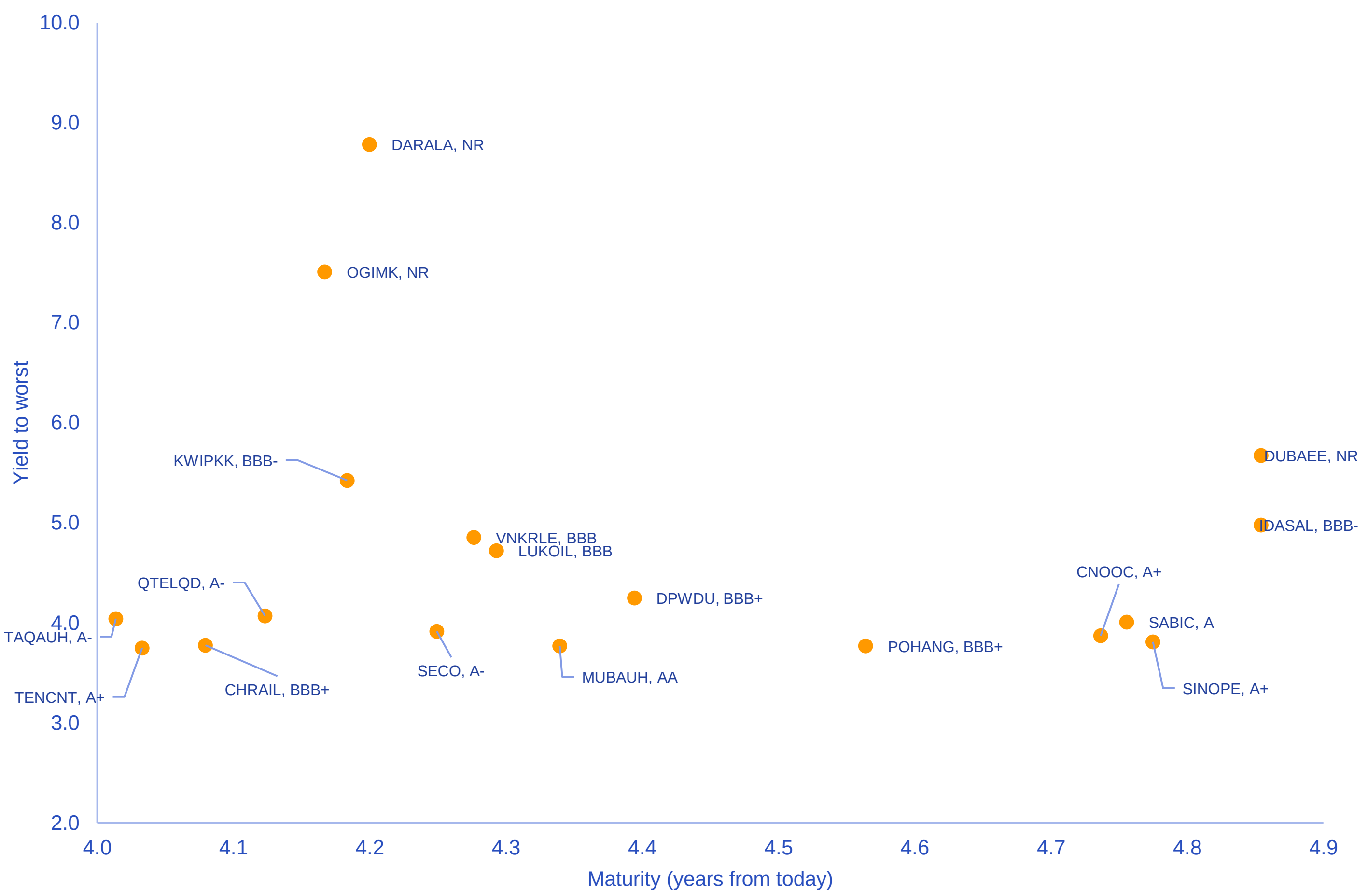
GCC sovereign CDS spreads appear cheap compared with similar rated counterparts




Source: Bloomberg

# GCC Corporates - Relative value

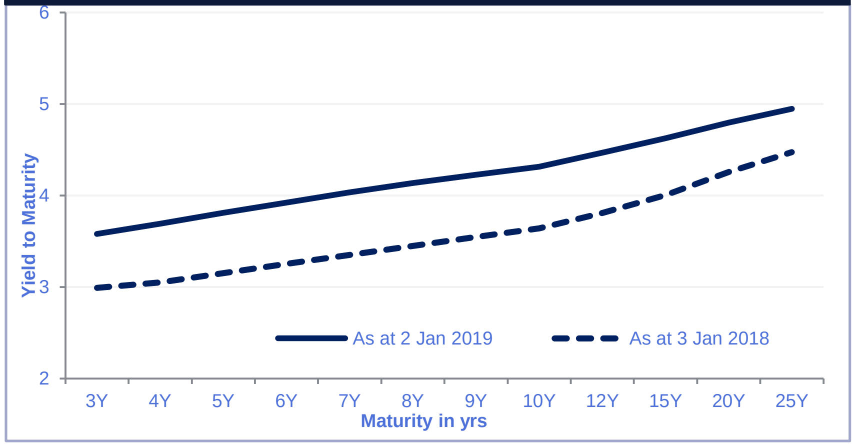
- Large GCC corporates tend to have substantial government ownership and expectations of support and therefore may be perceived as stronger credits than what their credit ratings reflect. That said current trading levels do not reflect this strength.



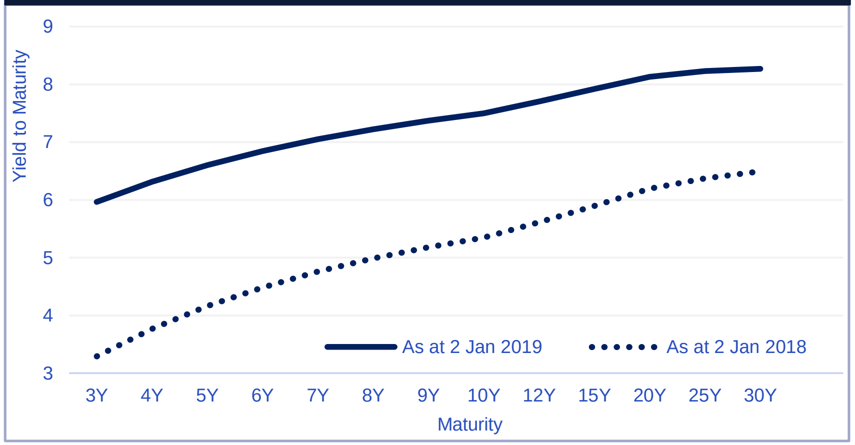

Source: Bloomberg

# GCC sovereign curves shifted upwards in line with the UST benchmark yield curve

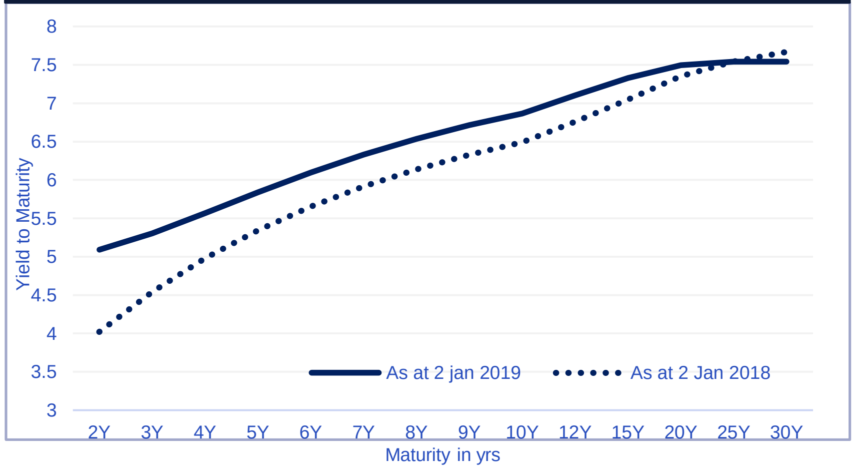
## Saudi Curve



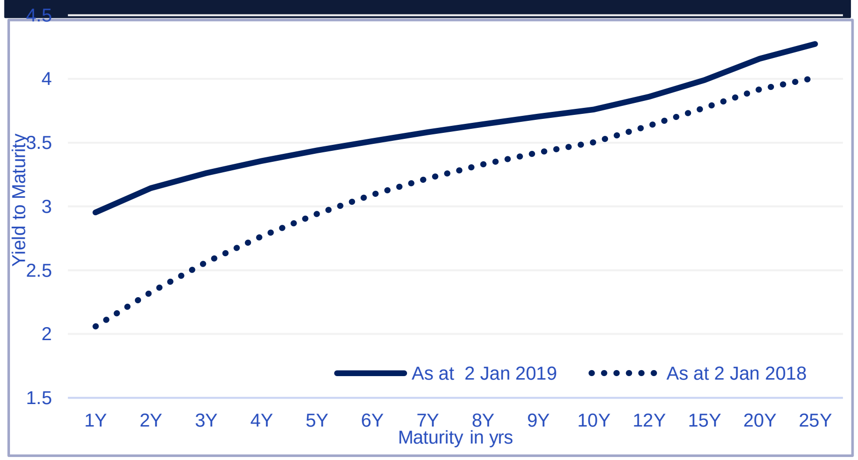

## Oman Curve




## Bahrain Curve




## Abu Dhabi Curve




Source: Bloomberg

# 2019 Redemptions

Circa $16 billion worth of fixed rate USD redemptions are due in 2019.

| Ticker | Maturity | Amt Out | Ticker | Maturity | Amt Out |
|---|---|---|---|---|---|
| DARALA | 5/28/2019 | 400 | QATAR | 4/9/2019 | 1000 |
| KUWAIE | 8/4/2019 | 250 | KWIPKK | 2/5/2019 | 233 |
| ADGB | 4/8/2019 | 1500 | QTELQD | 6/10/2019 | 600 |
| RAKBNK | 6/24/2019 | 722 | MUBAUH | 5/6/2019 | 500 |
| FABUH | 8/13/2019 | 750 | HSBC | 10/1/2019 | 400 |
| DAMACR | 4/9/2019 | 271 | DOLNRG | 6/15/2019 | 205 |
| MAFUAE | 7/5/2019 | 500 | EMAAR | 7/18/2019 | 500 |
| ETISLT | 6/18/2019 | 900 | JAFZSK | 6/19/2019 | 237 |
| DICUH | 2/20/2019 | 300 | RASGAS | 9/30/2019 | 615 |
| NBOBOM | 10/7/2019 | 300 | TAQAUH | 9/16/2019 | 500 |
| EBIUH | 11/19/2019 | 1000 | ADCBUH | 3/4/2019 | 750 |
| ADCBUH | 9/16/2019 | 600 | FABUH | 1/14/2019 | 500 |
| COMQAT | 11/18/2019 | 600 | CBQKQD | 4/22/2019 | 150 |
| FLYDU | 11/26/2019 | 500 | COMQAT | 4/25/2019 | 155 |
| COMQAT | 6/24/2019 | 750 | | | |

Source: Bloomberg

# Investment Strategy

**While rising interest rates are negative for bonds, on a hedged basis, we see pockets of opportunities. Value will come from security picking and relative value positioning rather than directional gains. We see benefit in below positioning trends:**

- **Sovereigns and Quasi (technical bid from being included in the EMBI index) over corporates.**
- **Sub debt / Tier 1 securities over senior .**
- **Long term exposure (curve flattening trades) over short term.**
- **High yield bonds (less sensitive to interest rate rises) over investment grade.**
- **Structured amortising securities over bullets.**
- **Be aware of M&A risk.**

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