



بنك الإمارات دبي الوطني
Emirates NBD

GCC Bonds
2 July 2018

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

GCC Bonds: Is The Worst Behind Us?

Year to date total return on Barclays Bloomberg GCC Bond Index has been a loss of 2.12%, much in line with our expectations at the beginning of the year and almost entirely attributed to the rising benchmark UST yields.

GCC Bond Indices vs Peers

	OAS (bps)	YTD Chg (bps)	YIELD (%)	YTD Chg (bps)	YTD Rtn %
US IG Corp	123	+29	4.02	+71	-3.27
US Aggregate	44	+8	3.33	+53	-1.62
EM USD Aggregate	300	+77	5.69	+123	-3.84
GCC IG + HY	191	+36	4.59	+86	-2.12
GCC IG	164	+34	4.41	+84	-1.99

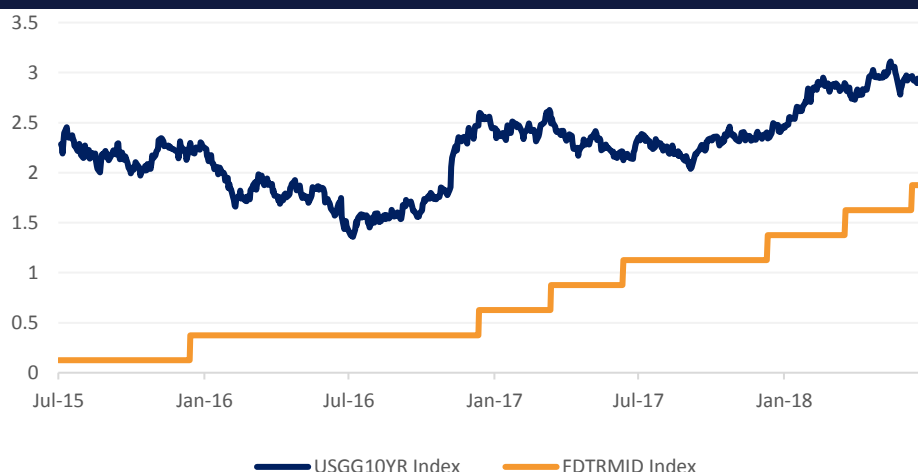
Source: Bloomberg, Emirates NBD Research

The recent sell off in EM bonds on the back of increasing risk aversion arising from strengthening dollar and increasing trade tensions has made valuation attractive on a historical basis. Though several risks continue to lurk on the horizon, we believe it may be time to begin looking at the GCC bonds favourably, particularly in light of following factors:

Rising benchmark yields are becoming a manageable risk

Economic growth in the US is at cyclical high and inflation is expected to increase from here. US Federal Reserve is set to raise its target rate by another 100 to 150 bps over the next two years. That said, we think the UST benchmark yield curve in the longer end is unlikely to rise materially given the uncertain global trade outlook and increasing possibility of the US economic growth having peaked. While Fed has raised interest rates seven time by a total of 175bps since December 2015, yield on 10yr US treasuries has only increased 60bps from 2.26% in December 2015 to 2.86% now. We don't expect yields on 7-10yr part of the curve to rise by more than 25-75bps even if Fed's target rate was to increase by another 100bps over the next 12 months. GCC bond index has an average duration of circa 6.5 yrs. A 50bps increase in yield on 5yr benchmark USTs can obviously cause bond prices to fall, however, the fall can be cushioned by the average 4.5% running yield on GCC bonds now.

GCC Bond index vs Peers



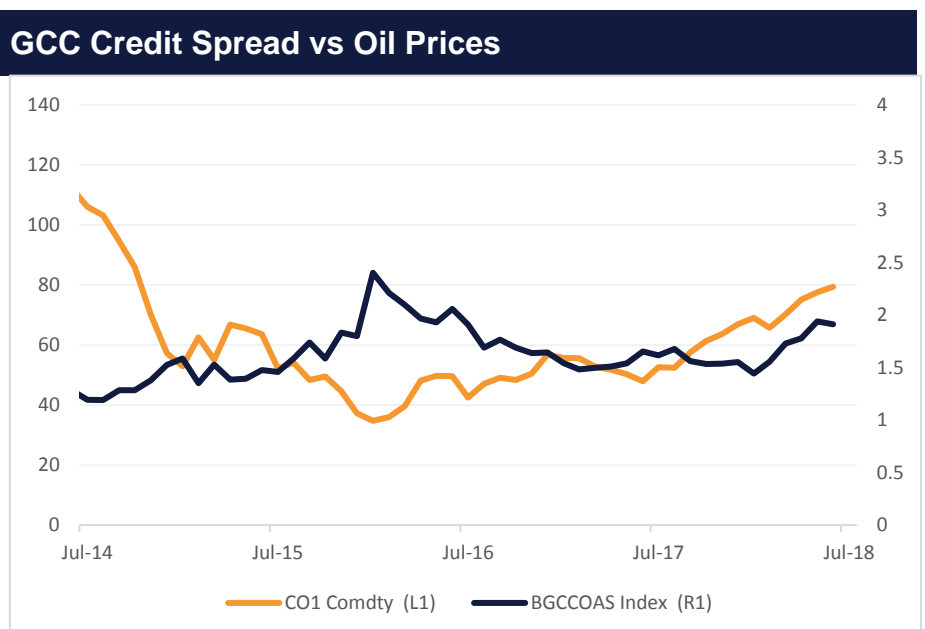
Source: Bloomberg, Emirates NBD Research

Stronger dollar and capital outflows will affect EM bonds

The 3-month long trade war between largest economies of the world - US and China - has left financial markets in a conundrum. EM currencies have come under pressure and capital outflows are evident. In this environment, GCC bonds are better placed than their EM counterparts given that there is no local currency debt market in the region and currencies are generally pegged to the dollar. Also, barring oil, GCC countries do not export material amount of other trade items and therefore the trade tensions are unlikely to have much direct impact on GCC economies.

Rising oil prices are a credit positive

Historically there has been strong co-relation between oil prices and credit spreads in the region. Oil prices have more than doubled from their low of \$28/b in early 2016 to over \$79/b now. Though higher oil prices have not translated into tighter credit spreads so far, they do provide a stable platform for spread tightening once the dust on geopolitical issues settles.



Source: Bloomberg, Emirates NBD Research.

Rating downgrades have plateaued

More than two thirds of GCC bonds are issued by sovereigns and sovereign related entities. Though Abu Dhabi and Kuwait based issuers remained largely unscathed, bulk of other issuers faced rating downgrades due to weakening credit profile ensuing from lower oil prices during the years 2014 to 2017. However, this trend seems to have bottomed out now. Recently Fitch revised the outlook on Qatar's 'AA' rating from negative to stable. We expect pressure on sovereign credit profiles to ease from here.

Economic growth in GCC is expected to improve

Fall in oil production affected GCC economies negatively, causing economic growth in KSA and Kuwait to contract, that in UAE and Oman to almost stagnate and that in Bahrain and Qatar to slow. With oil production set to increase and GCC governments losing purse strings to stimulate economic activity, GDP growth in the GCC region is expected to increase from weighted average of 0.1% last year to 2.0% this year to 3.3% next year. Rising economic growth should boost investor sentiment and help improve the bid for GCC bonds.

New bond supply is expected to slow

Current budgets of GCC sovereigns are generally based on oil price assumptions of around \$55/b. Oil revenues are likely to be higher than budget, thereby shrinking the need for additional debt to fund budget deficits and consequently reducing the supply of new bonds from sovereign issuers in the region. Slowing new supply is expected to halt the recent rise in new issue premiums.

GCC credit story is currently underappreciated

In the last two years, GCC governments have improved their debt management functions, enhanced disclosures, controlled corruption, streamlined their budgets, enacted reforms and modernized cultures. Rising oil prices have helped to cut budget deficits materially and current account balances have returned to surpluses. The underlying improvement in sovereign's credit profiles largely remains underappreciated and have not yet translated in rating upgrades. We expect rising oil prices and improving economic growth to stimulate international investors' appetite for GCC bonds where average credit quality still remains multi-notches higher than their EM counterparts.

GCC (Nominal GDP weighted average)

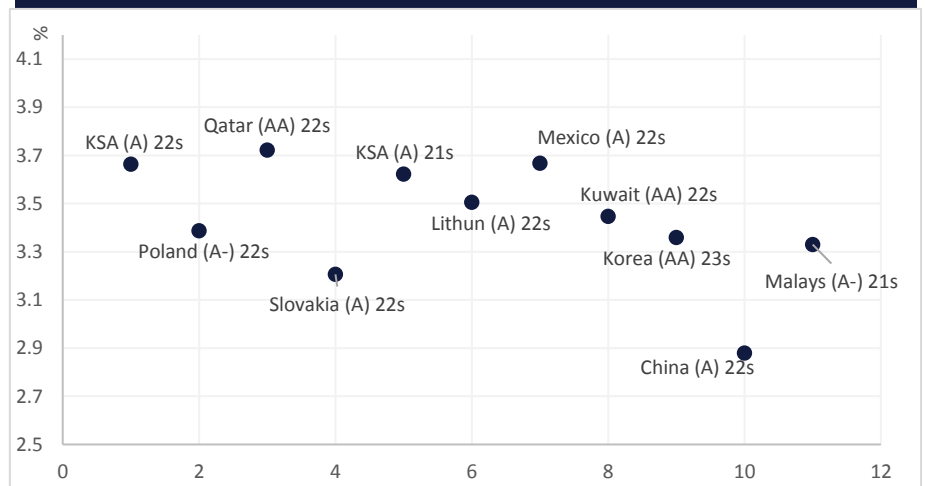
	2015	2016	2017	2018	2019
Nominal GDP \$bn	433	427	452	500	518
Current A/c % of GDP	-2.4	-3.1	2.4	7.1	5.9
Budget Balance % of GDP	-10.8	-10.7	-7.0	-3.1	-2.9

Source: Emirates NBD Research

GCC bonds are attractive on relative value

In view of lingering uncertainties relating to sanctions on Iran, military conflict in Yemen, diplomatic dispute between Qatar and its neighbours etc, GCC sovereigns are currently trading noticeably cheaper than their similar rated global peers. We expect value hunters to eventually look to close this gap.

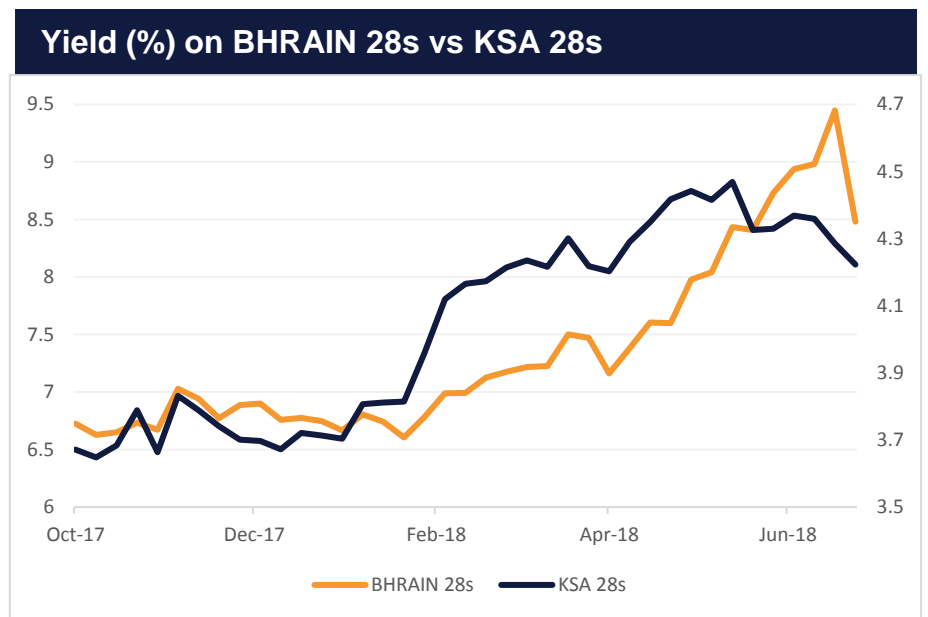
GCC bonds trade cheaper than their EM peers – YTW%



Source: Bloomberg, Emirates NBD Research

Bahrain is likely to get support from its neighbours

Of the six GCC countries, Bahrain's finances are the weakest and though it is well known name in the investment community, its access to international debt market is compromised by high refinance risk and junk category credit rating. Investors remain wary of the contagion risk if Bahrain was to default. Bahrain's CDS spreads and Z-spread on its cash bonds are currently at their record high. While remaining cautious, we continue to believe that the possibility of Bahrain receiving support from its neighbours is high.



Source: Bloomberg, Emirates NBD Research

Disclaimer

PLEASE READ THE FOLLOWING TERMS AND CONDITIONS OF ACCESS FOR THE PUBLICATION BEFORE THE USE THEREOF. By continuing to access and use the publication, you signify you accept these terms and conditions. Emirates NBD reserves the right to amend, remove, or add to the publication and Disclaimer at any time. Such modifications shall be effective immediately. Accordingly, please continue to review this Disclaimer whenever accessing, or using the publication. Your access of, and use of the publication, after modifications to the Disclaimer will constitute your acceptance of the terms and conditions of use of the publication, as modified. If, at any time, you do not wish to accept the content of this Disclaimer, you may not access, or use the publication. Any terms and conditions proposed by you which are in addition to or which conflict with this Disclaimer are expressly rejected by Emirates NBD and shall be of no force or effect. Information contained herein is believed by Emirates NBD to be accurate and true but Emirates NBD expresses no representation or warranty of such accuracy and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in the publication. The publication is provided for informational uses only and is not intended for trading purposes. Charts, graphs and related data/information provided herein are intended to serve for illustrative purposes. The data/information contained in the publication is not designed to initiate or conclude any transaction. In addition, the data/information contained in the publication is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to their determination. The publication may include data/information taken from stock exchanges and other sources from around the world and Emirates NBD does not guarantee the sequence, accuracy, completeness, or timeliness of information contained in the publication provided thereto by or obtained from unaffiliated third parties. Moreover, the provision of certain data/information in the publication may be subject to the terms and conditions of other agreements to which Emirates NBD is a party.

None of the content in the publication constitutes a solicitation, offer or recommendation by Emirates NBD to buy or sell any security, or represents the provision by Emirates NBD of investment advice or services regarding the profitability or suitability of any security or investment. Moreover, the content of the publication should not be considered legal, tax, accounting advice. The publication is not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law or regulation. Accordingly, anything to the contrary herein set forth notwithstanding, Emirates NBD, its suppliers, agents, directors, officers, employees, representatives, successors, assigns, affiliates or subsidiaries shall not, directly or indirectly, be liable, in any way, to you or any other person for any: (a) inaccuracies or errors in or omissions from the publication including, but not limited to, quotes and financial data; (b) loss or damage arising from the use of the publication, including, but not limited to any investment decision occasioned thereby. (c) UNDER NO CIRCUMSTANCES, INCLUDING BUT NOT LIMITED TO NEGLIGENCE, SHALL EMIRATES NBD, ITS SUPPLIERS, AGENTS, DIRECTORS, OFFICERS, EMPLOYEES, REPRESENTATIVES, SUCCESSORS, ASSIGNS, AFFILIATES OR SUBSIDIARIES BE LIABLE TO YOU FOR DIRECT, INDIRECT, INCIDENTAL, CONSEQUENTIAL, SPECIAL, PUNITIVE, OR EXEMPLARY DAMAGES EVEN IF EMIRATES NBD HAS BEEN ADVISED SPECIFICALLY OF THE POSSIBILITY OF SUCH DAMAGES, ARISING FROM THE USE OF THE PUBLICATION, INCLUDING BUT NOT LIMITED TO, LOSS OF REVENUE, OPPORTUNITY, OR ANTICIPATED PROFITS OR LOST BUSINESS. The information contained in the publication does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. Anyone proposing to rely on or use the information contained in the publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts regarding information contained in the publication. Further, references to any financial instrument or investment product is not intended to imply that an actual trading market exists for such instrument or product. In publishing this document Emirates NBD is not acting in the capacity of a fiduciary or financial advisor.

Emirates NBD and its group entities (together and separately, "Emirates NBD") does and may at any time solicit or provide commercial banking, investment banking, credit, advisory or other services to the companies covered in its reports. As a result, recipients of this report should be aware that any or all of the foregoing services may at times give rise to a conflict of interest that could affect the objectivity of this report.

The securities covered by this report may not be suitable for all types of investors. The report does not take into account the investment objectives, financial situations and specific needs of recipients.

Data included in the publication may rely on models that do not reflect or take into account all potentially significant factors such as market risk, liquidity risk and credit risk. Emirates NBD may use different models, make valuation adjustments, or use different methodologies when determining prices at which Emirates NBD is willing to trade financial instruments and/or when valuing its own inventory positions for its books and records. In receiving the publication, you acknowledge and agree that there are risks associated with investment activities. Moreover, you acknowledge in receiving the publication that the responsibility to obtain and carefully read and understand the content of documents relating to any investment activity described in the publication and to seek separate, independent financial advice if required to assess whether a particular investment activity described herein is suitable, lies exclusively with you. You acknowledge and agree that past investment performance is not indicative of the future performance results of any investment and that the information contained herein is not to be used as an indication for the future performance of any investment activity. You acknowledge that the publication has been developed, compiled, prepared, revised, selected, and arranged by Emirates NBD and others (including certain other information sources) through the application of methods and standards of judgment developed and applied through the expenditure of substantial time, effort, and money and constitutes valuable intellectual property of Emirates NBD and such others. All present and future rights in and to trade secrets, patents, copyrights, trademarks, service marks, know-how, and other proprietary rights of any type under the laws of any governmental authority, domestic or foreign, shall, as between you and Emirates NBD, at all times be and remain the sole and exclusive property of Emirates NBD and/or other lawful parties. Except as specifically permitted in writing, you acknowledge and agree that you may not copy or make any use of the content of the publication or any portion thereof. Except as specifically permitted in writing, you shall not use the intellectual property rights connected with the publication, or the names of any individual participant in, or contributor to, the content of the publication, or any variations or derivatives thereof, for any purpose.

YOU AGREE TO USE THE PUBLICATION SOLELY FOR YOUR OWN NONCOMMERCIAL USE AND BENEFIT, AND NOT FOR RESALE OR OTHER TRANSFER OR DISPOSITION TO, OR USE BY OR FOR THE BENEFIT OF, ANY OTHER PERSON OR ENTITY. YOU AGREE NOT TO USE, TRANSFER, DISTRIBUTE, OR DISPOSE OF ANY DATA/INFORMATION CONTAINED IN THE PUBLICATION IN ANY MANNER THAT COULD COMPETE WITH THE BUSINESS INTERESTS OF EMIRATES NBD. YOU MAY NOT COPY, REPRODUCE, PUBLISH, DISPLAY, MODIFY, OR CREATE DERIVATIVE WORKS FROM ANY DATA/INFORMATION CONTAINED IN THE PUBLICATION. YOU MAY NOT OFFER ANY PART OF THE PUBLICATION FOR SALE OR DISTRIBUTE IT OVER ANY MEDIUM WITHOUT THE PRIOR WRITTEN CONSENT OF EMIRATES NBD. THE DATA/INFORMATION CONTAINED IN THE PUBLICATION MAY NOT BE USED TO CONSTRUCT A DATABASE OF ANY KIND. YOU MAY NOT USE THE DATA/INFORMATION IN THE PUBLICATION IN ANY WAY TO IMPROVE THE QUALITY OF ANY DATA SOLD OR CONTRIBUTED TO BY YOU TO ANY THIRD PARTY. FURTHERMORE, YOU MAY NOT USE ANY OF THE TRADEMARKS, TRADE NAMES, SERVICE MARKS, COPYRIGHTS, OR LOGOS OF EMIRATES NBD OR ITS SUBSIDIARIES IN ANY MANNER WHICH CREATES THE IMPRESSION THAT SUCH ITEMS BELONG TO OR ARE ASSOCIATED WITH YOU OR, EXCEPT AS OTHERWISE PROVIDED WITH EMIRATES NBD'S PRIOR WRITTEN CONSENT, AND YOU ACKNOWLEDGE THAT YOU HAVE NO OWNERSHIP RIGHTS IN AND TO ANY OF SUCH ITEMS. MOREOVER YOU AGREE THAT YOUR USE OF THE PUBLICATION IS AT YOUR SOLE RISK AND ACKNOWLEDGE THAT THE PUBLICATION AND ANYTHING CONTAINED HEREIN, IS PROVIDED "AS IS" AND "AS AVAILABLE," AND THAT EMIRATES NBD MAKES NO WARRANTY OF ANY KIND, EXPRESS OR IMPLIED, AS TO THE PUBLICATION, INCLUDING, BUT NOT LIMITED TO, MERCHANTABILITY, NON-INFRINGEMENT, TITLE, OR FITNESS FOR A PARTICULAR PURPOSE OR USE. You agree, at your own expense, to indemnify, defend and hold harmless Emirates NBD, its Suppliers, agents, directors, officers, employees, representatives, successors, and assigns from and against any and all claims, damages, liabilities, costs, and expenses, including reasonable attorneys' and experts' fees, arising out of or in connection with the publication, including, but not limited to: (i) your use of the data contained in the publication or someone using such data on your behalf; (ii) any deletions, additions, insertions or alterations to, or any unauthorized use of, the data contained in the publication or (iii) any misrepresentation or breach of an acknowledgement or agreement made as a result of your receiving the publication.