GCC Bond Market Update

بنك الإمارات دبي الوطني
Emirates NBD

Credit Note
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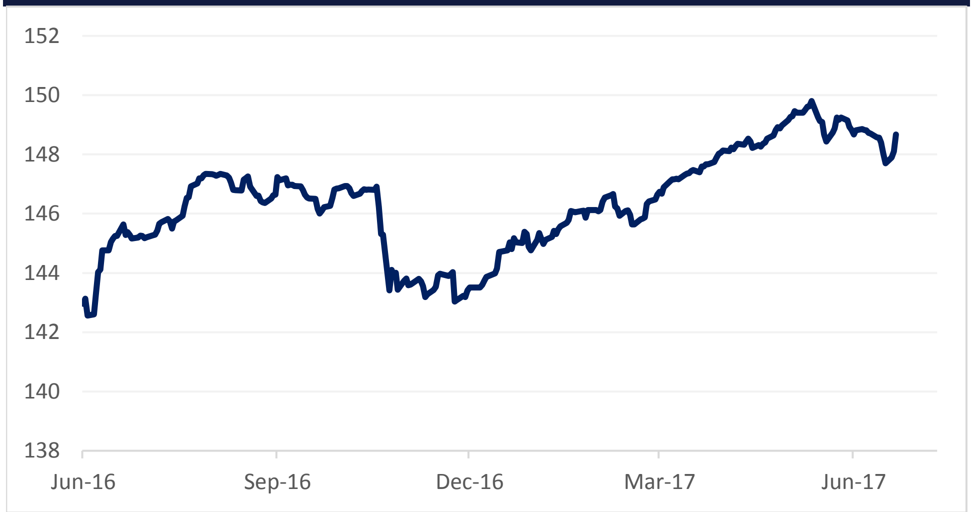
GCC bonds have had a constructive first half with total return on Bloomberg Barclays GCC index exceeding 3.35% despite a 15% fall in oil prices since the beginning of this year. Though capital gains have been limited, contribution from coupon collection has helped in keeping the total return healthy. There has been no material difference between the performance of conventional bonds and sukuk securities.

Yields on 2yr UST had increased circa 20bps to 1.38% in the half year ending June 30th which negatively affected the shorter dated bonds, however, it was more than compensated by lower yields on medium to longer dated part of the curve with yields on 5yr, 10yr and 30yr UST ending the first half at 1.89% (-5bps), 2.31% (-13bps) and 2.84% (-22bps) respectively. Given large issuance of longer dated bonds by sovereigns in the region recently, average duration of GCC bonds portfolio has increased from circa 5yrs few years ago to close to 8 years now. Higher duration of the portfolio has proven beneficial in the environment of yield curve flattening.

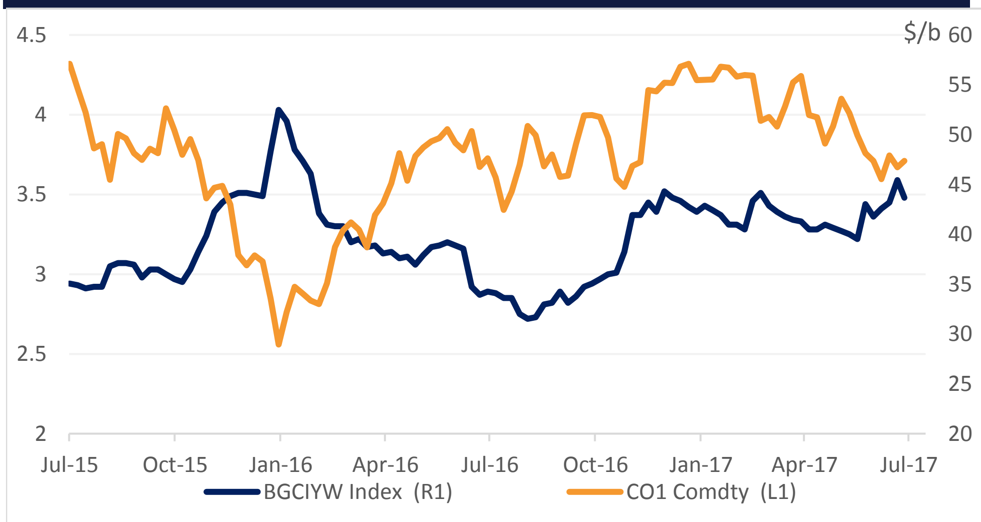
Bloomberg Barclays GCC Total Return Index



Source: Bloomberg, Emirates NBD Research.

Though YTD performance was healthy, the outlook for the second half is more cautious in view of recent bearish trend in oil prices. Even though governments in the region are making substantial efforts to diversify their respective economies away from heavy reliance on hydrocarbons, correlation of credit spreads on GCC bonds with oil price continues to remains high.

Bloomberg Barclays GCC Index Yield vs Oil Price



Beside oil prices, current topic of concern for investors is the ongoing disagreements between Qatar and some of its neighbours. Lack of certainty about the longevity of the rift has seen financial market participants becomes wary and cautious on GCC risk. Credit default swaps on GCC sovereigns have widened in the recent weeks and appear cheaper relative to their other emerging market peers.

CDS on GCC sovereigns vs other EM countries

Name	5yr CDS	YTD Chg.	High	Low
Abu Dhabi	57	-4	38	64
Bahrain	247	-55	212	303
Dubai	124	-25	104	150
Kuwait	80	-31	49	117
Qatar	106	18	106	125
Saudi Arabia	103	-	86	118
India	82	-12	99	82
Malaysia	84	-54	82	137
Egypt	400	-52	328	451
Philippines	73	-13	87	71

Source: Bloomberg, Emirates NBD Research.

International investors are closely assessing the impact of the current situation on Qatar's economy and financial health of its banking sector. Qatar equities have declined, bond prices have dropped, credit default swaps have almost doubled and interbank rates have risen materially. Rating agencies, understandably, are watching the situation closely and have either placed Qatar's sovereign rating on watch negative or revised the outlook to negative. Below we assess the magnitude of impact on Qatar financial markets.

Qatar's External Liabilities

Qatar government and corporates – including GREs and banks have circa $56 billion outstanding in external bonds and sukuk. Of this, $2.4 billion is due for redemption this year and another $11 billion in 2018. Besides, Moody's estimate that corporates have other external liabilities of circa $115 billion of which roughly half are made of non-resident deposits in the financial sector. Of the external liabilities roughly one third are owed to GCC creditors. Therefore **rough estimates would place liabilities from GCC creditors that would need refinancing or rollover between now and end of 2018 to be in the range of $20 - $25 billion.**

On the other hand, in terms of foreign assets, QIA had assets worth circa $300 billion as at end 2016, mostly tied in long term investments. Also Central Bank's foreign exchange reserves excluding gold are around $35 billion.

Impact on Qatar Credit Ratings

Moody's had downgraded Qatar's sovereign rating from Aa2 to Aa3 with stable outlook on 26th May 17, well before the eruption of the current diplomatic crisis. Key drivers for the rating downgrade were a weakening of Qatar's external position and uncertainty over the sustainability of the country's growth model beyond the next few years.

Moody's had expected fiscal and economic reforms, coupled with sizable reserve buffers to help shield Qatar's credit profile from deteriorating further and for it to remain consistent with an Aa3 rating. **However, on 5th July, the rating outlook was revised to negative, citing concerns that a prolonged period of uncertainty will negatively affect business and foreign investor sentiment and could also weigh on the government's long-term diversification plans to position the country as a hub for air traffic, tourism, medical services, education, and sports through a higher risk perception among foreign investors.**

Qatar Credit Rating Changes

	From	To	Date
Standard and Poor's	AA/Negative	AA-/ CWN	6 June 2017
Moody's Investor Services	Aa3/stable	Aa3/Negative	5 July 2017
Fitch Ratings	AA/stable	AA/CWN	12 June 2017

Source: Emirates NBD Research.

S&P downgraded Qatar's rating from AA to AA- on 6th June and placed the rating on credit watch negative citing concerns about the negative impact of the political situation on Qatar's economic growth and fiscal metrics. Qatar's fiscal and current account deficits could widen as revenue from regional trade diminishes. S&P's rating could be downgraded if government indebtness increases materially quicker than the current expectation of Debt /GDP to remain below 50%

Fitch placed its AA rating on Qatar on negative watch on 12th June stating that the isolation could not only adversely affect the public finances but also could undermine the business model of Qatari companies, including SOEs, potentially requiring costly bail-outs. As per Fitch, the risk of further logistical and financial restrictions is increasing, and the risk of the use of military force, while still remote, can no longer be entirely excluded. Domestically, the isolation could lead to strains between those advocating reconciliation with Saudi Arabia and those supporting the highly independent position that Qatar has pursued so far, bringing political stability into question.

In addition to the actions on the sovereign rating, Moody's last week also revised the outlook on 10 banks in Qatar to negative. The rating actions were driven by 1) the weakening domestic operating environment, particularly for banking funding, resulting in the rating agency lowering the Macro Profile it assigns to Qatar to Moderate+ from Strong--; and 2) the weakening capacity of the Qatar government to support the country's banks.

Qatar CDS

Credit default swaps on 5yr Qatar obligations almost doubled to over 124bps after the imposition of embargoes on Qatar by the blockade members.

The underlying reference obligation for Qatar CDS is the senior debt of Qatar and its guaranteed subsidiaries including Qatari Diar Finance Co. As at Q2 2017, outstanding debt of Qatar government and guaranteed subsidiaries is circa $55.3 billion. Including the interest obligations of about $15 billion, principal + interest obligations amounts to circa $70 billion in total. Of this about $43 billion falls due over the next five and half years.

Lack of deep domestic capital markets increases the government's reliance on external funding, thereby increasing the probability of default somewhat, however in this case it is remote in view of Qatar's sizeable foreign assets and FX reserves.

Qatar – 5yr CDS History (bps)

Source: Bloomberg, Emirates NBD Research.

Though 5yr CDS spread has reduced 17bps over the last week to 105bps, it still compares unfavourably to likes of Malaysia at 83bps (rated A- with debt of over $158 billion) and Korea at 58bps (rated AA with debt of circa $76 billion).

Qatar Interbank Rates

Of the six GCC states, Qatar banking system generally has the highest loan-to-deposit ratio and relatively high reliance on external funding. Banking sector liquidity is boosted by non-resident deposits, partly drawn from neighbouring nations.

3m QIBOR (%)

Source: Markit, Emirates NBD Research.

Qatar National Bank, the largest bank in Qatar with market share in excess of 35% based on assets, disclosed that only 4% of its total deposits of QAR 562bn ($154 billion) are from GCC investors.

Qatar Bonds

Bonds from Qatar - both government and non-government - fell noticeably last month though now have begun to stabilise or even slightly reverse the losses. Bonds issued by Ezdan Holdings, the real estate business majority owned by the Qatari ruling family, fell nearly 7%. ERESQD 21 closed last week at $94.7 compared with over $101.19 in mid-May. Qatar government bonds fell across all tenures. Qatar 23s were down 3% while QATAR 40s were down around 2%. There has been no material difference between the performances of bonds vs sukuk securities from the country.

In contrast, project cashflow related bonds such as the ones issued by RASGAS and Nakilat were better supported by the investors. RASGAS 27s as well as QGTS 33s remained largely range-bound.

Select Qatar Cash Bonds

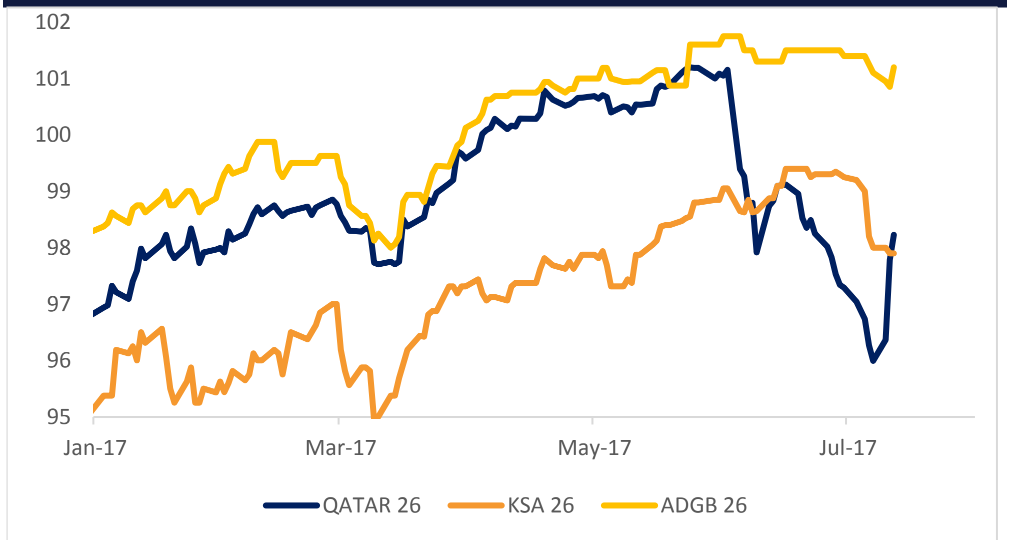
Issuer	Final Maturity	Z-Spread	Price	3m Chg.
Ezdan Holdings	04/05/2022	416	95.24	-4.70
Commercial Bank of Qatar	06/13/2021	193	98.19	-2.28
SoQ Sukuk a QSC	01/18/2023	121	100.28	-2.44
QIB sukuk Ltd	10/27/2020	196	97.05	-2.70
Ooredoo International Finance	01/31/2043	188	101.36	-1.11
Qatar Govt International Bond	06/02/2021	107	98.12	-1.27

Source: Bloomberg, Emirates NBD Research.

Hope of an amicable resolution have increased in the last few days which in turn has caused some renewal of appetite for the Qatar exposure which in turn has seen yields tightening on Qatar curve over the last few days.

QNB, Qatar's largest bank reported quarterly result reflecting 2% increase in 2Q profit to QAR 3.45bn. Customer deposits increased 15% to QAR 562 billion against an 11% increase in loans to QAR 552 billion - leading to Loan-to-deposit ratio of 98%. As per media reports based on statements from QNB officials, only 4% of QNB's deposits come from the Gulf states involved in the blockade and the bank has seen minimal withdrawals. This has boosted investor confidence in the resilience of the banking sector despite Moody's revising the outlook on several banks to negative.

Qatar cash bonds vs peers ($)



Source: Bloomberg, Emirates NBD Research.

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