Debt markets

GCC: Yields rattled by global markets; issuance picks up on sovereigns

> Chaker El Mostafa
Economist
+965 2259 5356, chakermostafa@nbk.com

> Nemr Kanafani
Head of Banking and Finance Research
+965 2259 5365, nemrkanafani@nbk.com

GCC yields moved mostly lower in 3Q15 as an expected US Fed interest rate increase was delayed, and in spite of new government debt, actual and expected. For the more fiscally vulnerable, risk premiums appeared to jump on the decline in oil prices. The stock of outstanding conventional bonds saw a healthy expansion on the back of increased sovereign issuance. However, this may have led to some crowding-out of private sector activity, with the latter being largely absent in 3Q15. Nonetheless, we expect GCC issuance to pick up in the coming months across the board.

GCC bond markets appeared to be expecting a US rate hike for most of 3Q15 before easing slightly after the Fed chose to wait last September. Expectations of a rate hike by the Fed saw GCC yields rise in anticipation early 3Q15. However, the lackluster global environment saw the probability of a rate increase in September diminish. When the decision to delay a Fed move came, GCC yields moved down further.

Yields on some GCC bonds rose as oil prices declined to new lows in 3Q15 and concerns over fiscal sustainability reemerged. Fears of slower oil demand growth, led by weaker Chinese economic data, and an ongoing supply glut saw oil prices hit new lows in August. This caused some to review the fiscal vulnerability of the GCC countries. Yields rose for the more fiscally vulnerable sovereigns such as Bahrain.

Despite the volatility, yields declined in 3Q15 for most GCC sovereigns. Rates on 4-5 year paper were down between 12 and 28 bps for Abu Dhabi, Dubai, and Qatar to settle at 1.60%, 3.11%, 2.14%, respectively. Meanwhile, Bahrain saw its yield increase by 37 bps on the back of fiscal and political concerns.

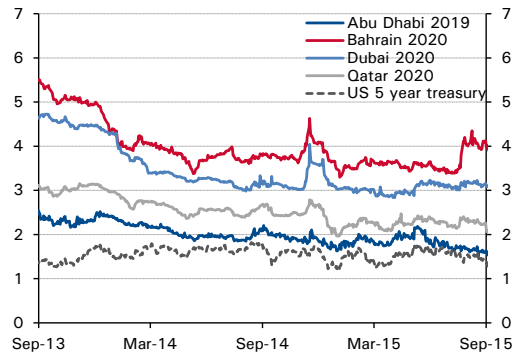
GCC yields are still expected to rise with a federal funds rate hike, if and when it happens. The prospect of a US rate hike before yearend seems increasingly unlikely as global developments are being given more weight in the Fed's decision making. Fear of triggering mass emerging market capital outflows and global financial volatility, combined with increased weakness in China, have added another layer of complexity to the Fed's decision making. Still, with 13 of the 17 FOMC participants indicating a willingness to raise the fed funds target in 2015, a hike is still a slight possibility.

Credit default swap (CDS) rates have risen on concerns over GCC government finances, led by Saudi Arabia's. After recovering from OPEC's decision in late 2014, oil producers saw their CDS rates shoot up once again late in 3Q15, following further decline in oil prices during the quarter. CDS rates were up between 12 and 20 bps quarter on quarter for the more vulnerable, Bahrain and Dubai, as well as for Abu Dhabi and Qatar, which have more comfortable fiscal conditions.

Meanwhile, Saudi Arabia saw its risk premium diverge from the rest of the GCC, rising by 73 bps, to settle at 134 bps at the end of 3Q15. Weaker oil prices have seen Saudi Arabia draw down its foreign reserves at a faster than expected pace, as it financed ambitious development spending and an ongoing ground war in Yemen. This has raised new concerns about the adequacy of the country's fiscal buffers, which was

Chart 1: GCC sovereign yields

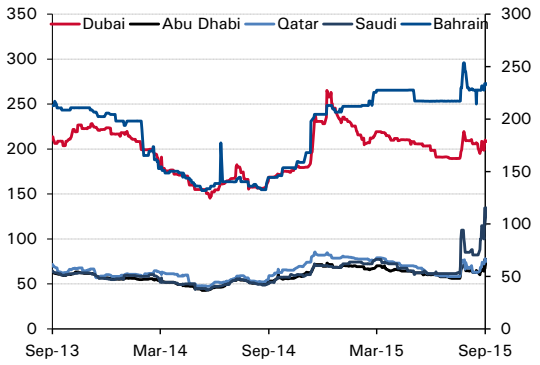
(%)



Source: Thomson Reuters Datastream

Chart 2: GCC credit default swaps

(basis points)



Source: Thomson Reuters Datastream

Chart 3: Brent oil price

($/bbl)

Source: Thomson Reuters Datastream

further aggravated by recent declines in oil prices during 3Q15.

The stock of outstanding conventional GCC bonds was boosted by sovereign issuance in 3Q15, driven by Saudi Arabia, while bank and corporate activity was virtually absent. Outstanding conventional bonds were up 9.6% y/y at the end of 3Q15, following almost two years of slower growth. GCC sovereigns have turned to debt markets to help finance budget deficits. Saudi Arabia led the issuance, offering its first bonds since 2007. Concerned with the rapid drawdown of reserves, Saudi Arabia opted to access its domestic debt market to help sustain expenditure plans. So far, Saudi Arabia has issued $20 billion in domestic debt and aims to issue a total of $36 billion in 2015. Bahrain and Oman returned to debt financing as well, each issuing government development bonds to the tune of USD 925 million and USD 780 million, respectively. Meanwhile Qatar continued to issue its usual government bonds in an ongoing effort to develop its local debt market.

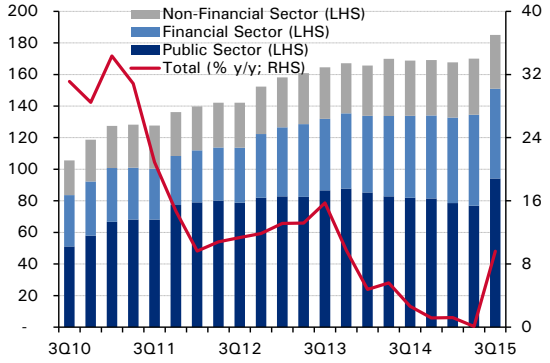
With most GCC sovereigns now turning to debt markets for financing, maintaining investor confidence is becoming paramount. Despite recent downgrades, all of the GCC countries seem to have maintained relatively healthy ratings with a slight bias to the downside for the fiscally vulnerable. At their current low levels of debt, GCC countries have plenty of room for credit growth, strongly backed by their sovereign funds, positive economic outlooks, and stable FX regimes.

Rising sovereign issuance risks crowding out private sector debt. Banks across the GCC have been keen buyers of recent sovereign issues. As a result, this has absorbed some of the excess liquidity on their balance sheets, pushing up interbank rates. Liquidity in the system has already come under pressure as government revenues from oil receipts declined. The perception that risks in the region are on the rise could also see investors ask for higher returns. A recent primary offering by an Emirati corporate and another by an Emirati bank were priced out as a result.

GCC issuance activity is expected to pick up as regional financing needs remain large and issuers maintain robust ratings. Sovereigns will turn to debt markets in a bid to protect their reserves, while banks will continue to issue debt to meet their needs from adherence to capital regulations and to financing future credit growth. Meanwhile, corporates will continue to look to debt markets to diversify their funding and finance future growth.

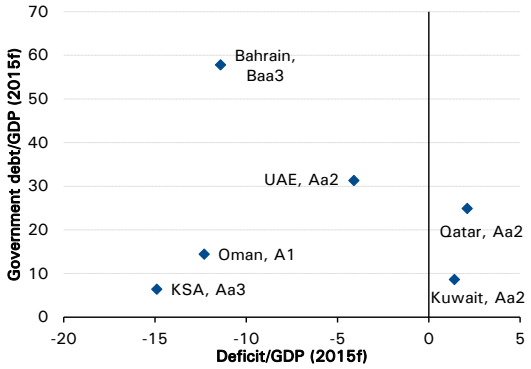
Chart 4: Outstanding conventional GCC bonds

($ billion)



Source: Zawya

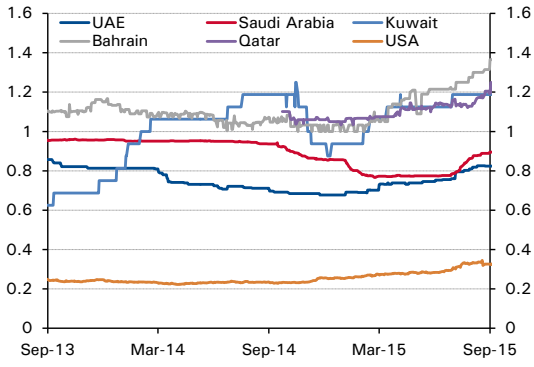
Chart 5: GCC debts, budget balances, and ratings



Source: Moody's

Chart 6: GCC interbank rates

(%)



Source: Thomson Reuters Datastream

Head Office

Kuwait
National Bank of Kuwait SAK
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAK
Bahrain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait
Bahrain Branch (H.O)
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAK
Head Office - Dubai
Latifa Tower, Sheikh Zayed Road
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait
Abu Dhabi - Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAK
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAK
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAK
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAK
Singapore Branch
9 Raffles Place #24-01/02
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAK
Shanghai Representative Office
Suite 1003, 10th Floor, Azia Center
133 Yin Cheng Bei Road, Lujiazui
Shanghai 200120
China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353

© Copyright Notice. The Economic Brief is a publication of the National Bank of Kuwait. No part of this publication may be reproduced or duplicated without the prior consent of NBK.
While every care has been taken in preparing this publication, National Bank of Kuwait accepts no liability whatsoever for any direct or consequential losses arising from its use. GCC Research Note is distributed on a complimentary and discretionary basis to NBK clients and associates. This report and other NBK research can be found in the "Reports" section of the National Bank of Kuwait's web site. Please visit our web site, www.nbk.com, for other bank publications. For further information please contact: NBK Economic Research, Tel: (965) 2259 5500, Fax: (965) 2224 6973, Email: econ@nbk.com