Economic Update

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Debt markets

US treasury yields rise in 3Q20 amid improved economic data and stimulus expectations

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Highlights

- **Global bond yield movements were mixed in Q3 as investors weighed improving macroeconomic data against virus uncertainty.**
- **GCC bond yields continued to trend downwards on a lower perceived risk, strong investor demand, and more stable oil prices.**
- **Yield prospects will depend on economic recovery, vaccine availability and developments in terms of the US presidential office transition.**
- **GCC debt issuance has been strong so far this year, on track to exceed $100 billion, driven by deficit financing needs.**

Yields continue to be influenced by recovery expectations

Global bond yield movements in 3Q20 were mixed, with yields in the UK and the US reversing course and rising modestly as improving economic data and stimulus expectations fueled hopes for a sustained economic recovery. On the other hand, EU yields continued to slide, weighed down by renewed virus-related concerns, while GCC yields-- which typically are subject to different dynamics and carry more risks compared to advanced countries-- decreased on a slightly improving economic environment. On a more recent note, US yields reached 0.98%, the highest since March, helped by stronger than expected US economic data, positive vaccine news, and reduced political uncertainty.

With the strong bond issuances seen so far this year in the GCC, the region is on track to issue a record amount of debt in 2020, as governments seek to finance rising deficits brought on by the pandemic and lower oil prices. GCC dollar-denominated Eurobonds and domestic currency issuances totaled a solid $35 billion in 3Q20, led by Saudi Arabia, pushing total issuance this year to about $98 bilion and the total regional outstanding debt to a record $579 billion.

Global yield movements mixed amid ongoing uncertainty

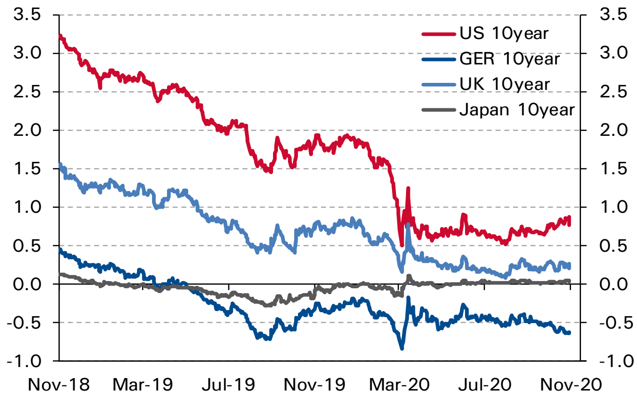
Global bond yield movements were mixed and saw increased volatility in 3Q20, as investors weighed the improvement in macroeconomic data and continued fiscal support against ongoing virus uncertainty and the threat of renewed national lockdowns. Gains in 10-year bond yields were led by UK Gilts and US treasuries, which rose by 6 bps and 2 bps respectively q/q, benefitting from positive stimulus and recovery expectations, and a record amount of US bond offerings, which reached $15.5 trillion this year as of the end of September, keeping supply buoyant and pushing prices down (yields up).

More recently, US 10 year treasury yields rose higher to 0.98% as of November 11, the highest since March, helped by better than expected economic data, positive vaccine news, the end of US elections and stimulus optimism.

Looking forward, under president-elect Biden, a large stimulus deal is possible (though may face opposition depending on the make-up of the senate) which will have a lifting effect on treasury yields. Additional upward pressure may come in the case of a sustained economic recovery and the possible approval of a coronavirus vaccine, which could occur before the end of the year, with possible vaccine roll-out around 2Q or 3Q of 2021.

Chart 1: Global benchmark yields

(%)



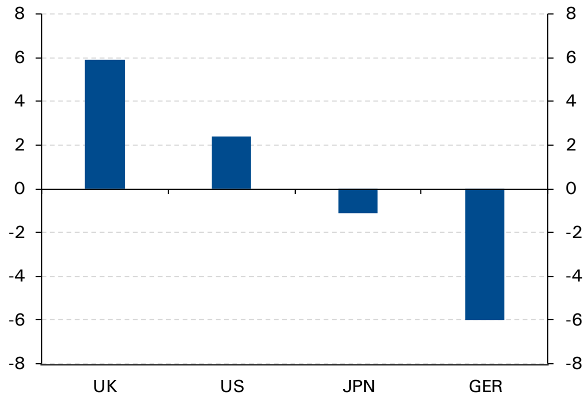
Source: Refinitiv, as of November 5

On the other hand, persistently low inflation coupled with low interest rate expectations could cap potential gains in US treasury yields, as could therisk from a a resurgent virus with a second wave of business and mobility restrictions, especially under the Biden administration which is expected to adopt a more stringent policy on COVID-19 which will almost certainly weigh down on economic activity, sentiment, and consequently bond yields. Further, the possibility of a formal dispute regarding election results may raise uncertainty and cap potential gains in US yields.

Moving on to the EU, the benchmark German bund continued to trend down on a loose ECB monetary policy, namely negative interest rates, and a large bond purchase program. The 10-year bund led the decline in global yields, down by 6 bps q/q in 3Q and a further 10 bps since then to -0.62% as of November 4 amid renewed lockdowns in the EU in response to a spike in new virus cases. Meanwhile, the 10-year Japanese bond yield, typically stable, was little changed as the BOJ maintained its -0.1% interest rate target and its pledge to cap 10-year bond yields around zero.

Chart 2: Change in global 10-year yields (Q/Q)

(basis points)



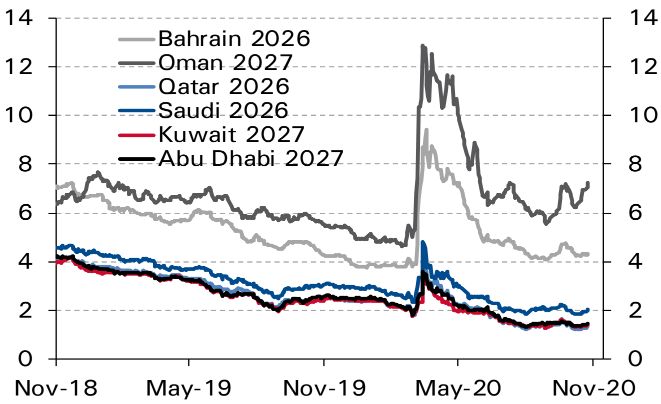
Source: Refinitiv

GCC yields trend down in 3Q20 amid recovering economy

GCC medium-term sovereign bond yields mostly continued to trend downwards in 3Q20. This follows a spike in yields in the earlier months of the pandemic (April/May), reflective of the higher perceived risk of GCC sovereigns, pressured by the twin shocks of the pandemic and historically low oil prices. The declines were helped by an improving economic scene after the lifting of restrictions and the partial recovery of oil prices, thus lending support to confidence and alleviating some pressure on weaker fiscal positions arising from lower oil prices and weak, lockdown-induced business activity. Additionally, strong investor demand continues to apply downward pressure on yields, evident by the high and well-recieved regional debt offerings during 3Q. Qatar, Abu Dhabi, Saudi, and Kuwaiti yields declined by 28, 28, 19, and 17basis points respectively. In contrast, Omani and Bahraini medium term yields surged as investors priced in the higher risk of these countries due to their lower credit ratings, high debt to GDP ratios, pressure on foreign reserves a slow expected economic recovery and a pressing need for fiscal reform. Oman and Bahrain sovereign yields rose by 44 and 32 bps respectively in 3Q20, with the former's yield rising further in October following the second sovereign credit rating downgrade by global rating agencies this year.

Chart 3: Medium-term GCC sovereign yields

(%)

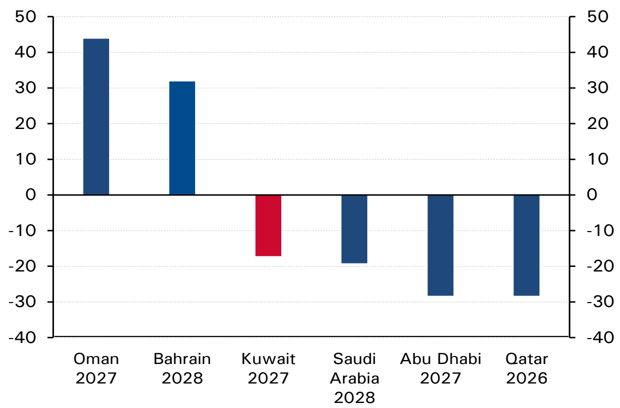


Source: Refinitiv, as of November 5

Looking forward, GCC yield movements will continue to be influenced by oil market stability, the pace of economic recovery and the degree to which the pandemic is controlled. A sustained improvement in economic activity and a stable oil market will help to keep yields subdued. Further, the strong investor demand (given the relatively low yielding global alternatives) is expected to continue, which will likely keep yields low. On the other hand, a resurgent virus with the possibility of renewed lockdowns will impede a potential economic recovery, adding pressure on fiscal positions and consequently leading to higher yields. In the likely event of oil prices remaining below GCC fiscal break-even prices, issuances will likely remain strong for some time for deficit financing, keeping supply high and pushing yields up.

Chart 4: Change in GCC medium-term sovereign yields (Q/Q)

(basis points)



Source: Refinitiv

Moreover, the fact that US treasury yields are currently on an uptrend, while GCC yields have mostly declined, translates into a tighter spread, meaning that sooner or later, GCC yield declines will likely be capped, especially given that they are currently at multi-year lows, thereby maintaining their higher risk premia versus developed market yields.

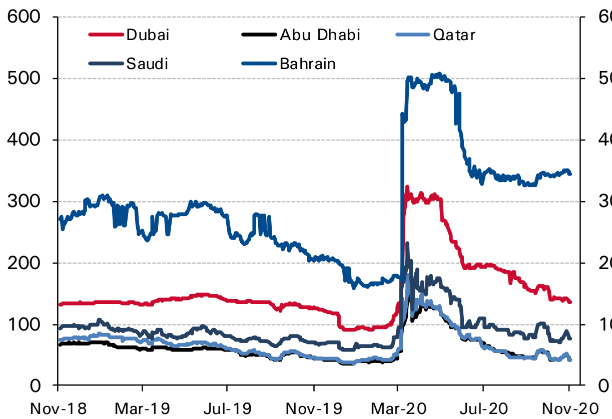
GCC issuance remains strong on higher financing needs

Regional issuance has been strong so far this year, on track to exceed $100 billion for the full year, driven by a high need for financing amid mounting fiscal pressures due to lower oil prices and the pandemic induced economic slowdown, encouraged also by a relatively low cost of financing. About $35 billion in dollar and domestic currency bonds and sukuk was issued in 3Q20, bringing YTD issuance to $98 billion and pushing the total outstanding debt in the GCC to a record $579 billion

GCC issuance during 3Q20 was dominated by Saudi sovereign sukuk, totaling $17.4 billion, comprising the bulk of GCC issuance during the quarter. Other notable offerings include a total of $4 billion in UAE sovereign bonds in July and September, and more recently in October, a $2 billion, two tranche bond issuance from Oman with 7 and 12 year maturities. Looking forward, we expect GCC issuance to remain strong as oil prices are likely to remain below the breakeven prices and economic activity will take time to fully recover, while public spending is unlikely to decrease materially. In Kuwait, the possible passing of a debt law to finance a large deficit would also pave the way for the restart of issuances in the coming period.

Chart 5: Credit default swaps on GCC sovereign debt

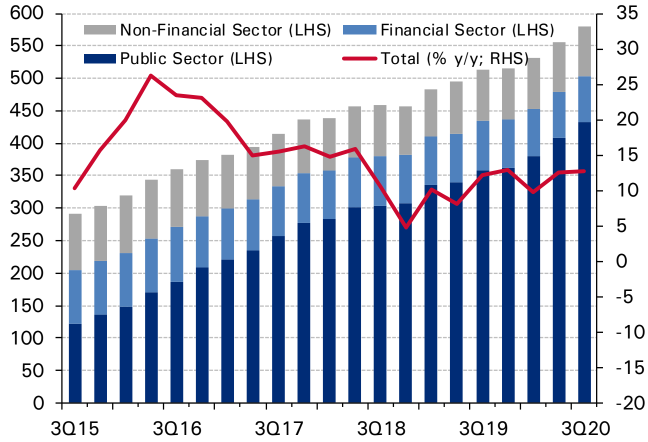
(Basis points)



Source: Refinitiv, as of November 5

Chart 6: GCC gross debt outstanding

($ billion)



Source: Refinitiv

Table 1: New GCC Issuance by sector ($ billion)

	4Q-17	1Q-18	2Q-18	3Q-18	4Q-18	1Q-19	2Q-19	3Q-19	4Q-19	1Q-20	2Q-20	3Q-20
Public Sector	23.8	8.0	25.9	5.8	5.9	32.5	22.8	23.6	8.1	16.6	35.4	29.1
Financial Sector	2.0	3.1	1.3	1.0	1.9	2.1	3.6	5.4	1.8	3.8	1.6	5.4
Non-Financial Sector	3.2	0.6	0.8	0.8	0.5	0.0	0.6	0.8	0.8	0.0	0.8	0
Total	**28.9**	**11.7**	**27.9**	**7.5**	**8.3**	**34.6**	**27.0**	**29.7**	**10.8**	20.4	37.7	34.6

Table 2: New GCC issuance by country ($billion)

	4Q-17	1Q-18	2Q-18	3Q-18	4Q-18	1Q-19	2Q-19	3Q-19	4Q-19	1Q-20	2Q-20	3Q-20
Bahrain	1.5	0.5	2.8	0.4	1.0	0.0	0.0	3.3	0.5	0.1	2.8	3.6
Kuwait	0.3	0.0	0.2	0.1	0.7	0.0	0.0	0.0	0.5	0.0	0.0	0.0
Oman	0.9	7.5	0.3	0.9	1.8	0.0	0.4	3.3	0.5	0.4	0.5	1.0
Qatar	0.0	0.5	17.3	2.6	1.5	15.6	5.1	4.7	0.4	3.1	11.0	1.6
KSA	12.6	0.5	4.5	1.3	0.0	16.3	17.8	3.6	3.6	13.6	7.8	23.1
UAE	13.6	2.6	2.8	2.2	3.4	2.7	3.8	14.8	5.3	3.2	15.7	5.3
GCC	**28.9**	**11.7**	**27.9**	**7.5**	**8.3**	**34.6**	**27.0**	**29.7**	**10.8**	**20.4**	**37.7**	**34.6**

Source: Refinitiv, data as of November 5

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