Debt markets

US treasury yields touch 15-month high as stimulus and vaccines lend support to outlook

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Highlights

- **Gains in benchmark yields during 1Q21 were led by the US 10-year note, which reached 1.75%, but eased as of late.**
- **European yields rose in line with US treasuries on hopes of a strong economic recovery in the second half of the year.**
- **A sustained rise in yields will depend on positive developments in the global economic and virus control scenes.**
- **GCC medium-term yields mostly tracked their global counterparts higher as the global economic and virus outlook improved.**
- **GCC issuances to remain robust in 2021 on ongoing deficits, but may ease amid higher oil prices and lower public spending.**

Global yields extend rally on recovery optimism

Global sovereign bond yields extended their rally in 1Q20, led by US treasuries with the 10-year note reaching a 15-month high at the end of March. The uptrend in yields was supported by the rollout of vaccines, an improving US macroeconomic backdrop and continued stimulus measures, thereby boosting optimism for an economic recovery and promoting a risk-on stance by investors who continued to pile into riskier asset classes including equities. The higher yields were also helped by rising inflation expectations as private spending picks up in line with the improved sentiment. Meanwhile, GCC yields tracked their global counterparts higher on recovery optimism and vaccine rollouts.

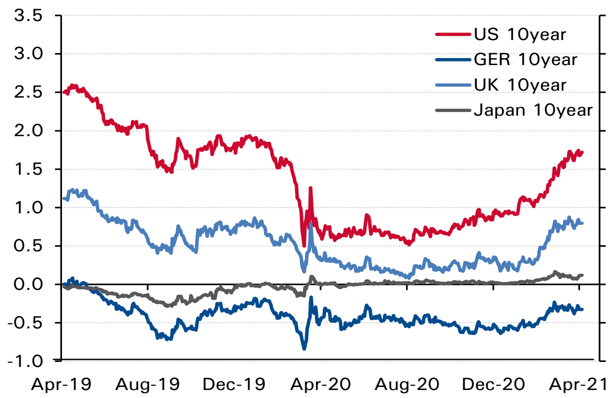
GCC sovereign debt issuance could moderate in 2021 from the elevated offerings of 2020 as the need for financing eases due to higher oil prices and consolidation efforts, though we still expect issuance to remain relatively robust on continued budget deficits and relatively low yields. In 1Q21, GCC debt issuance totaled $27.7 billion, up 108% y/y, led by Saudi sovereign offerings.

Global yields surge in 1Q21 on improving outlook

An improving virus scene thanks to the rollout of vaccines, coupled with ongoing stimulus support, stronger macroeconomic data and the easing of restrictions, has bolstered sentiment and led to a selloff in bonds, lifting yields in several cases to pre-pandemic levels (chart 1). This follows the sharp declines seen in 2020 as sentiment weakened in the wake of the coronavirus and its adverse effect on global economic growth. Gains in benchmark yields during 1Q21 were led by the US 10 year treasury, which reached a 15-month high of 1.75% on March 31st (+83 bps q/q) before easing notably in Mid-April on a surge in treasury bond purchasing, coupled with reassurances by the Fed that policy will remain accomodative and that the recent surge in inflation is transitory given the ongoing slack in the labor market.

Chart 1: Global benchmark yields

(%)



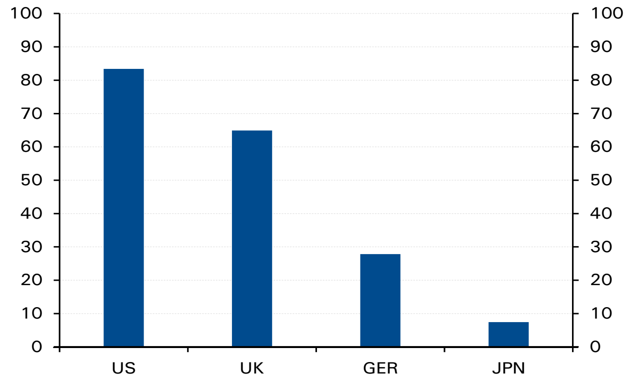
Source: Refinitiv, as of April 14

European yields, previously weighed down by the risk of a double-dip recession due to the spread of a new wave of covid-19, also rose in line with US treasuries, supported by higher inflation and hopes of a strong economic recovery in the second half of the year as the virus is reigned in. German Bunds and UK Gilts gained 65 and 28 bps q/q, respectively, while the Japanese 10-year yield rose by a lower 7 bps q/q, typically remaining near the 0% target mandated by the Bank of Japan (Chart 2).

Looking ahead, a sustained rise in yields will depend on the strength of the economic recovery which in turn depends on the extent to which the pandemic is controlled - an uncertain prospect given the emergence of new strains and still high infection rates in various parts of the world. Additional fiscal stimulus measures by the US government will likely drive yields higher as well as the expected easing of travel restrictions in 2H21 as vaccine rollouts continue to progress. On the other hand, assurances by the Fed that policy will remain accommodative and their view that the higher inflation will be transitory, will likely help to keep potential yield gains in check.

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

(basis points)



Source: Refinitiv

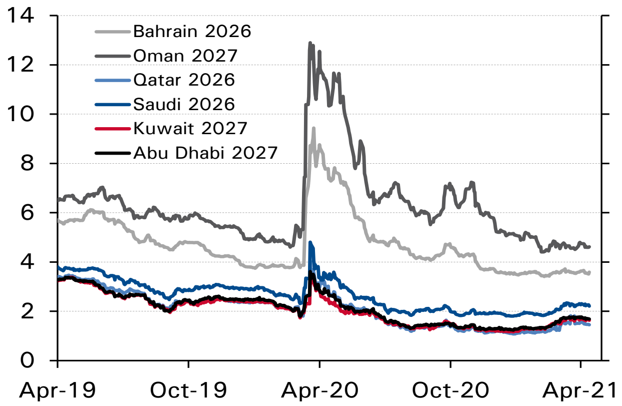
GCC yields track global peers higher in 1Q21

GCC medium term sovereign bond yields mostly tracked their global counterparts higher as the global economic and virus outlook improved. Though higher GCC yields are usually a characteristic of deteriorating economic conditions and weaker credit worthiness, the surge in yields in this case was largely influenced by higher global bond yields. Macroeconomic conditions in the GCC, in fact, saw a gradual improvement over the quarter, in line with higher oil prices, vaccination campaigns and better overall sentiment, reflected by a broad downtrend in credit default swap rates (chart 6). Yield increases, ranging from 44 to 58 bps, were observed in all GCC member states, except for Oman, where yields fell by 28 bps (charts 2 & 4). Oman, typically the highest yielding GCC sovereign due to its much lower sovereign credit rating (B+ "non-investment" grade by S&P) and higher risk profile, had a much greater margin for yield declines in line with the improving economic and virus conditions.

A strong appetite by global investors for higher yields (in a still relatively low global yield environment), likely kept demand for Omani debt high, pressuring yields lower. With that said, further yield declines in Oman will likely be capped by ongoing fiscal challenges and a weak sovereign rating, risks which investors will continue to demand a higher yield for. In the near to medium-term, GCC yield prospects will continue to depend on the regional/global economic recovery, direction of global yields, virus containment backdrop, in addition to oil prices. Specifically on Kuwait, a continued lack of much needed reforms, and a persistent and growing fiscal deficit could raise the future cost of borrowing on fears of further credit rating downgrades.

Chart 3: Medium-term GCC sovereign yields

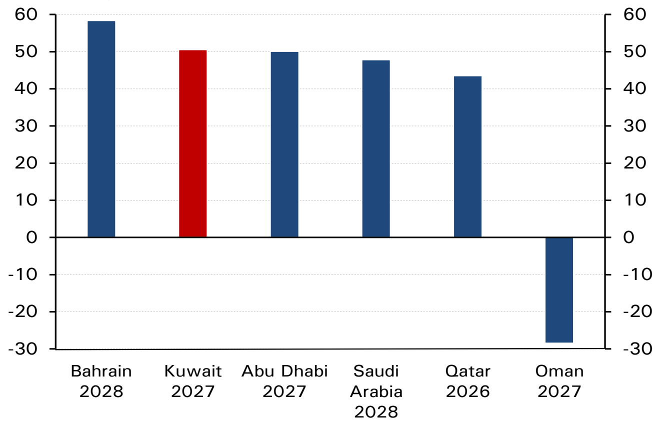
(%)



Source: Refinitiv, as of April 14

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

(basis points)



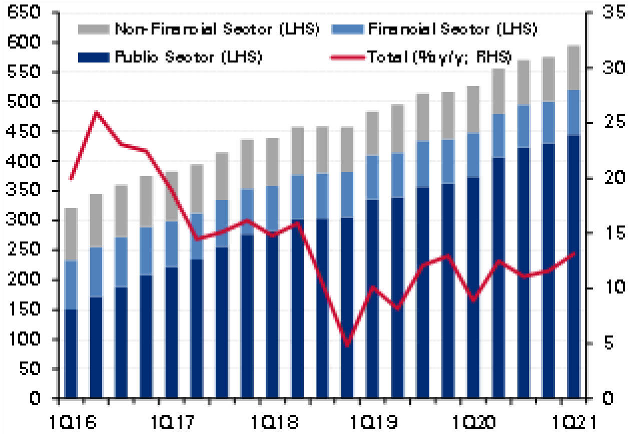
Source: Refinitiv

GCC issuances to ease but remain strong on continued financing needs

Following the high level of issuances in 2020, exceeding $100 billion and roughly in line with 2019 levels, the first quarter of 2021 saw the issuance of about $28 billion, dominated by sovereign paper and led by Saudi Arabia with $10.5 billion issued , bringing the total GCC outstanding debt to around $600 billion as of the end of the quarter (chart 5). The strong level of issuances was driven by the ongoing need to finance the budget deficits, encouraged also by a relatively low cost of borrowing. We expect GCC issuances to remain robust in 2021 to plug continuing deficits, but may ease relative to 2020 in line with higher oil prices, restrained government spending, and recovering economic activity. Further, given that interest rates remain low, it may be more prudent for GCC countries to resort to borrowing, rather than drawing down reserves, which are presumably generating higher rates of return. Passing the debt law in Kuwait would lead to an increase in total regional issuance. However, the timing of approval of the debt law remains uncertain at this time, awaiting an agreement between the parliament and the cabinet.

Chart 5: GCC gross debt outstanding

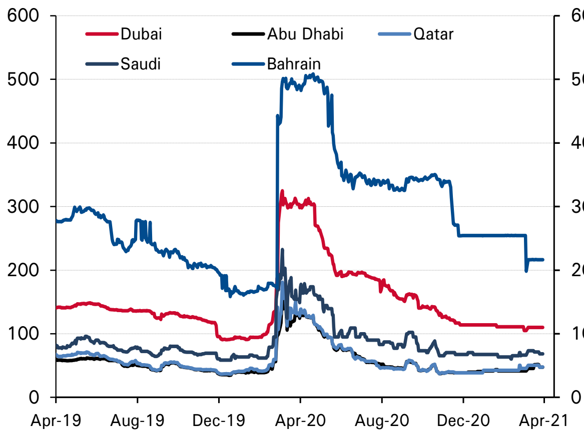
($ billion)



Source: Refinitiv

Chart 6: 5-year credit default swap rates

(Basis points)



Source: Refinitiv

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

	2Q-18	3Q-18	4Q-18	1Q-19	2Q-19	3Q-19	4Q-19	1Q-20	2Q-20	3Q-20	4Q-20	1Q-21
Public Sector	25.9	5.8	5.9	32.5	10.8	23.6	8.1	9.2	35.4	22.3	12.4	20.0
Financial Sector	1.3	1.0	1.9	2.1	3.6	5.3	1.8	4.1	1.6	4.4	2.1	6.4
Non-Financial Sector	0.8	0.8	0.5	0.0	12.6	0.8	0.8	0.0	1.0	0.0	0.8	1.3
Total	27.9	7.5	8.3	34.6	27.0	29.6	10.8	13.3	38.0	26.7	15.2	27.7

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

	2Q-18	3Q-18	4Q-18	1Q-19	2Q-19	3Q-19	4Q-19	1Q-20	2Q-20	3Q-20	4Q-20	1Q-21
Bahrain	2.8	0.4	1.0	0.0	0.0	3.3	0.5	0.1	2.8	3.2	0.0	3.0
Kuwait	0.2	0.1	0.7	0.0	0.0	0.0	0.5	0.0	0.0	0.0	0.5	0.0
Oman	0.3	0.9	1.8	0.0	0.4	3.3	0.5	0.4	0.5	1.0	3.8	6.1
Qatar	17.3	2.6	1.5	15.6	5.1	4.7	0.4	3.8	11.0	1.6	0.0	1.7
KSA	4.5	1.3	0.0	16.3	17.8	3.6	3.6	5.5	8.0	12.3	8.3	10.5
UAE	2.8	2.2	3.4	2.7	3.8	14.7	5.3	3.5	15.7	8.5	2.7	6.4
GCC	27.9	7.5	8.3	34.6	27.0	29.6	10.8	13.3	38.0	26.7	15.2	27.7

Source: Refinitiv, data as of April 14, 2021

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