PUBLIC

Economic Update

NBK Economic Research Department I 29 August 2022

Debt markets

Sovereign bond yields waver amid shifting inflation and monetary policy outlook

> Saqer Al-Zayed
Economist
+965 2259 5655
SaqerAlZayed@nbk.com

Highlights

- **Global bond yields have wavered but shown little net change in Q3 on shifting inflation, recession, and rate hike expectations.**
- **GCC medium-term sovereign yields are a little softer, with high oil prices benefitting fiscal positions and overall sentiment.**
- **Growth prospects, Fed policy, and inflation expectations will continue to drive international bond market dynamics.**
- **GCC issuance eased to around $8 billion in 2Q22 mostly from Saudi and UAE sovereign bonds and sukuk.**
- **Exceptionally low issuance could be due to rising interest rates versus last year, and reduced sovereign financing needs.**

Global yields see renewed climb after July drop

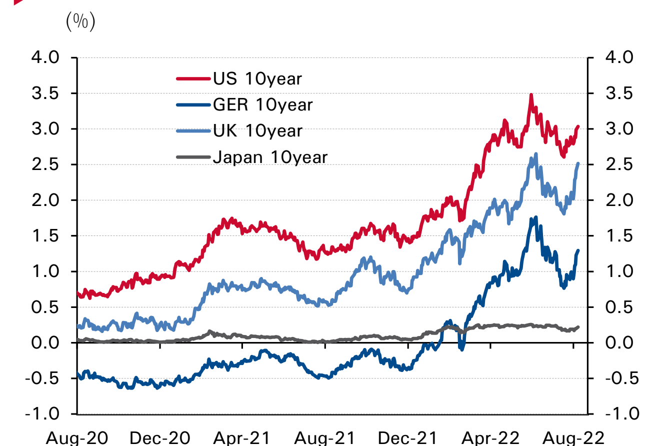
Renewed worries over central bank hawkishness to tame inflation led to a fresh spike in global bond yields in mid-August, reversing the broad decline seen in July and early August driven by signs of easing US inflation, weaker economic data, and in turn a less aggressive rate hike outlook. GCC yields followed a similar trend, edging back up in mid-August having eased previously with support from still elevated oil prices and improved economic prospects. Yields could continue to increase if inflation remains high and the Fed maintains its hawkish approach. On the other hand, potential yield increases could be limited should inflation decline materially or if growth weakens further, justifying a less hawkish stance by the Fed.

Meanwhile, GCC debt issuance eased to $8 billion* in 2Q22 from around $11 billion in 1Q22, mostly from Saudi and UAE sovereign bonds and sukuk offerings after the record levels of 2021 ($105 billion). The moderation in GCC debt issuance seen in 1H22 could continue into the second half of the year given much lower budgetary financing needs (due to higher oil prices) and rising borrowing costs.

Yields boosted recently by Fed hawkishness

The volatility in bond markets seen thus far in 3Q22 can be owed mainly to shifting inflation, growth and rate hike expectations. Signs that inflation may have peaked, with the deceleration in US CPI inflation in July, increased the likelihood of a Fed pivot towards less hawkish policy, especially given the technical recession and ongoing weakness in some economic data. These factors fueled demand for fixed-income and pushed yields down from their peak in June (of nearly 3.5% for the US 10-year). However, by mid-August, yields had partially reversed the steep declines of July/early August on hawkish Fed comments.

Chart 1: Global benchmark yields



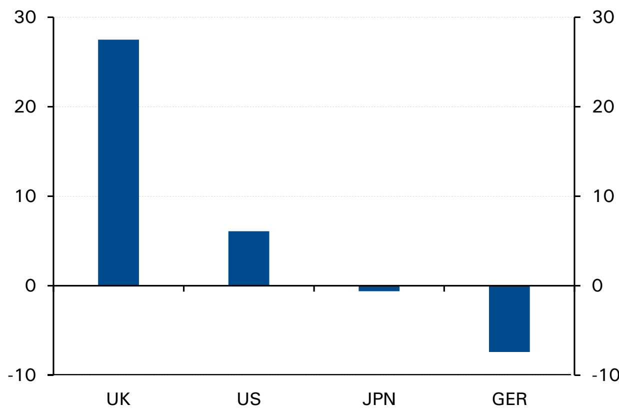
Source: Refinitiv, as of August 22

The net effect of this volatility has been only modest changes in yields on a quarter-to-date basis. Declines in Q3 in German and Japanese bonds (JGB) were curbed to just 7.4 bps and 0.6 bps respectively, although intra-period changes were much larger, peak-to-trough. Japan maintained its commitment to its zero yield policy, defending the bond from price falls, which boosted investor sentiment and demand for JGBs. Meanwhile the 10-year US Treasury yield increased by 6.1 bps to 3.04%, having fallen to below 2.6% in early August. The UK gilt saw the sharpest increase, propelled by double digit (10.1%) inflation for July, and the implications for higher interest rates.

Growth prospects, Fed policy, and inflation expectations will continue to drive bond market dynamics. The US 10-year treasury yield has further upside in the event of steep rate hikes, high inflation, and robust economic data. On the other hand, yield increases could be limited by a further possible decelaration in inflation and consequently a less hawkish approach by the Fed. The higher yields coupled with lower

returns in riskier assets should help demand for bonds, potentially capping large yield increases even if inflation remains quite high. The possibility of weaker economic growth should also boost safe haven demand for bonds.

Chart 2: Change in global 10-year yields
(basis points, quarter-to-date)

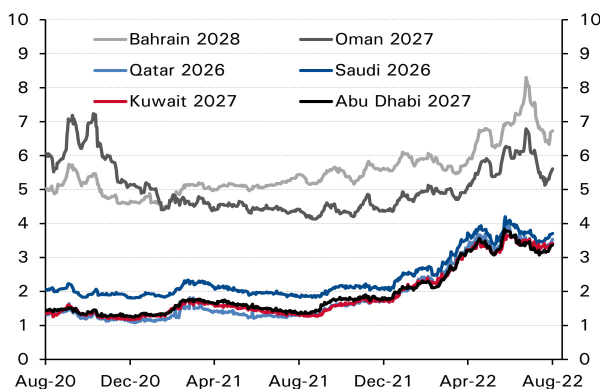


Source: Refinitiv as of August 22

GCC sovereign yields move broadly lower

GCC medium-term sovereign bond yields have fallen since June in tandem with international bond markets and a moderation in the regional rate hike outlook, which typically tracks Fed policy. Higher oil prices, strengthening economic prospects, and in turn lower risk profiles were additional contributing factors. Yield declines in Q3 to date were led by (still relatively higher-yielding) Bahrain and Oman, which fell over 50 bps each after increasing sharply in 2Q. Recently, Fitch upgraded Oman's sovereign credit rating to BB (stable) from BB-, citing significant improvements in the Sultanate's public finances, lessening external financing pressures, and continued commitment to fiscal reforms. On the other hand, Abu Dhabi, Qatar, and Saudi Arabia saw moderate declines, ranging 15 – 30 bps QTD, while Qatari bonds, among the lowest yielding of the group, declined the least (-7.1 bps), given the lack of new issuance and low sovereign risk.

Chart 3: Medium-term GCC sovereign yields
(basis points, quarter-to-date)

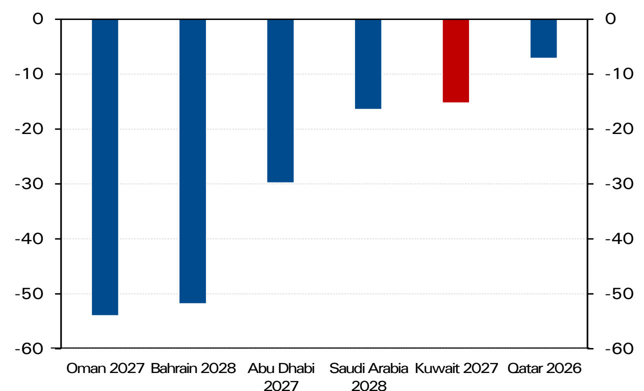


Source: Refinitiv as of August 22

Meanwhile, credit default swap rates for regional bonds fell in recent weeks, perhaps reflecting the lower risk associated with an improving operating environment.

Looking ahead, GCC yield movements will depend largely on inflation, central banks' policies and the economic recovery. GCC yields could continue to rise in 2H22 in line with global yields given still high inflation and the possibility of more steep rate hikes. That said, elevated oil prices and a much improved regional fiscal and economic outlook could lessen the potential for large increases in yields, given lower financing needs.

Chart 4: Change in GCC medium term yields
(basis points, quarter –to-date)



Source: Refinitiv, as of August 22

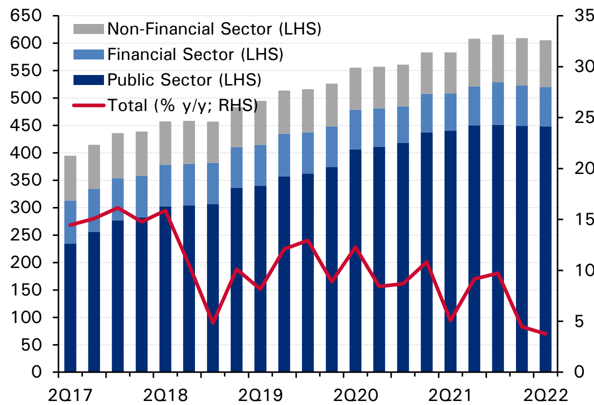
GCC issuance eases further in 2Q22

GCC domestic and eurobond (USD) issuance eased further to around \$8 billion in 2Q22, the lowest since 3Q18 and from around \$11 billion in 1Q21. GCC outstanding debt stood at \$605 billion as of the end of 2Q22, down slightly from Q1. The exceptionally low issuance could be due to the volatility in debt markets and rising regional yields, along with the absence of deficit financing needs amid elevated oil prices and the commitments to medium-term fiscal reforms. In addition to previous rate hikes, further increases are expected this year in line with the Fed's tightening cycle, leading to higher borrowing costs and a softer pace of GCC debt issuance. As such, most of the issuance this year appears to be refinancing-related as stated in the Saudi Debt Management Center annual borrowing plan.

Saudi Arabian sukuk comprised the bulk of debt offerings in 2Q22, with \$2.8 billion issued under the local Saudi Sukuk Issuance program in Saudi riyal, which aims to redeem eurobonds in exchange for domestic sukuk. Also of note is the UAE government bond issuance amounting to \$2.7 billion. Meanwhile, the Central Bank of Bahrain issued \$1.8 in sovereign bonds in three tranches with maturities of 5 and 10 years. Finally, Kuwaiti debt issuance will likely remain muted given the still-pending debt law, which will allow it to tap international and local debt markets, though unlikely until sometime after a new parliament is formed around October.

Chart 5: GCC outstanding debt

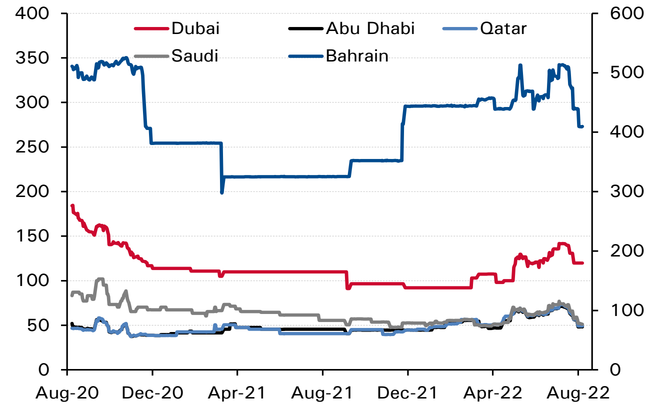
($ billion)



Source: Refinitiv

Chart 6: Five-year credit default swap rates

(Basis points)



Source: Refinitiv as of August 22

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

	3Q-19	4Q-19	1Q-20	2Q-20	3Q-20	4Q-20	1Q-21	2Q-21	3Q-21	4Q-21	1Q-22	2Q-22
Public Sector	23.6	8.1	17.3	35.4	22.3	12.4	25.4	14.9	12.1	14.0	9.7	6.9
Financial Sector	5.3	1.8	4.1	1.6	4.4	2.1	6.0	3.3	4.3	5.0	1.3	0.8
Non-Financial Sector	0.8	0.8	0.0	1.0	0.0	0.8	1.5	2.4	12.5	0.8	0.0	0.0
Total	**29.6**	**10.8**	**21.4**	**38.0**	**26.7**	**15.2**	**35.4**	**20.6**	**28.9**	**19.8**	11.0	7.7

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

	3Q-19	4Q-19	1Q-20	2Q-20	3Q-20	4Q-20	1Q-21	2Q-21	3Q-21	4Q-21	1Q-22	2Q-22
Bahrain	3.3	0.5	0.1	2.8	3.2	0.0	3.1	0.9	0.4	2.5	0.4	1.8
Kuwait	0.0	0.5	0.0	0.0	0.0	0.5	0.0	0.2	0.0	0.0	0.0	0.1
Oman	3.3	0.5	0.4	0.5	1.0	3.8	6.1	3.3	0.0	0.0	0.0	0.0
Qatar	4.7	0.4	3.8	11.0	1.6	0.0	1.7	2.0	17.9	1.1	0.0	0.5
KSA	3.6	3.6	13.6	8.0	12.3	8.3	17.2	3.8	2.5	11.0	7.0	2.8
UAE	14.7	5.3	3.5	15.7	8.5	2.7	4.9	10.4	8.0	5.2	3.6	2.7
GCC	**29.6**	**10.8**	**21.4**	**38.0**	**26.7**	**15.2**	**32.9**	**20.6**	**28.9**	**19.8**	**11.0**	**7.7**

Source: Refinitiv
*Debt issuance figures comprise notes and bonds issued in domestic and Eurobond (USD denominated only) markets with tenors of one year or more (excludes short-term bills).

Head Office

Kuwait
National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain 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 SAKP
Bahrain Head Office
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 SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
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 SAKP
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

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 SAKP
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

France
National Bank of Kuwait France SA
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
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 Update 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, Email: econ@nbk.com