Global yields show signs of stability on improving economic data, recovery optimism

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Highlights

- **Global bond yield declines have eased amid improved economic data and stronger optimism about the recovery.**
- **GCC bond yields continued to trend downwards on lower risk premiums against safe US assets due to recovering oil prices and economic activity.**
- **Yield prospects will depend on the swiftness of the economic recovery, the longevity of the pandemic and vaccine availability.**
- **GCC domestic and international bond/sukuk issuance has totalled $77 bn YTD, pushing outstanding debt to $563 bn.**

Decline in bond yields eases amid recovery optimism

The trend decline in global bond yields observed for the most part of the year has somewhat stabilized since May, curbed by easing virus concerns and improving economic data, a sign that the worst may be over for the global economy. This has stoked optimism and supported demand for riskier asset classes. In addition, large sovereign issuances to finance massive stimulus measures to counter the negative effects of the pandemic have helped limit the declines in yields. However, GCC sovereign yields have maintained a negative trajectory, driven by the continued strength in international demand and higher oil prices. Domestic and international bond and sukuk issuance totalled about $58 billion in 1H20, roughly in line with the $62 billion observed in 1H19.

Global bond yields stabilize but remain relatively low

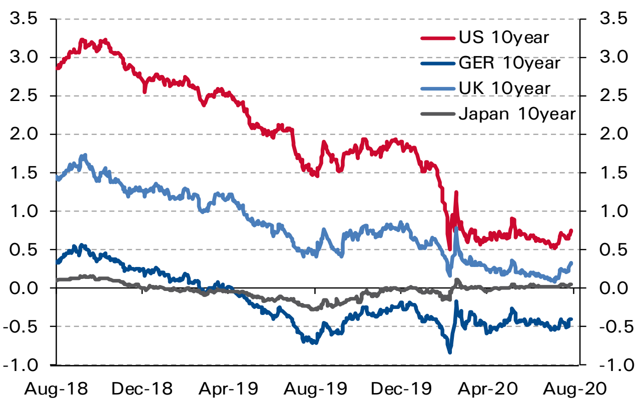
Vaccine hopes coupled with improving economic data such as US manufacturing, consumer spending and employment have led to improved investor sentiment and fueled hopes for a swift economic recovery, dampening investor demand for risk-free assets in favor of riskier alternatives (e.g. equities). Global yields are up from their March lows, but remain relatively depressed, capped by historically low interest rates and inflation, in addition to lingering virus and economic recovery uncertainty. (Chart 1.)

Looking back at the year, the drop in yields was led by US treasuries, with the 10-year yield down about 120 bps YTD to 0.73% as of August 28, with lower short-term policy rates and large Fed bond purchases more than offsetting the Treasury's ramping up of issuances to finance the soaring deficit. (Chart 2.) Also of note is speculation that the Fed may adopt a policy of yield-curve control similar to Japan's as a means of further stimulus – although Fed officials have remained cautious on this idea so far. More recently, the Fed in a dovish move switched to a 2% inflation target over time (flexible), which will practically allow monetary policy to remain loose. Indeed, following the announcement in late August, treasury yields responded immediately, with the US 10-year treasury surging 10 bps over the course of a few days to a 10-week high (0.75%).

In Europe, German Bund and UK Gilt yields have closely tracked their US counterpart, declining steeply earlier in the year before stabilizing in recent months, influenced by the same global factors as the US, namely recession and virus concerns coupled with central bank stimulus. In contrast, Japan's 10-year JGB yields have been relatively stable, supported by the Bank of Japan's 0% target yield policy. However, yields on even longer-term JGB's have risen noticeably since July, as the BoJ signalled it would stop increasing its purchases of super-long-term bonds (more than 10 years).

Chart 1: Global benchmark yields

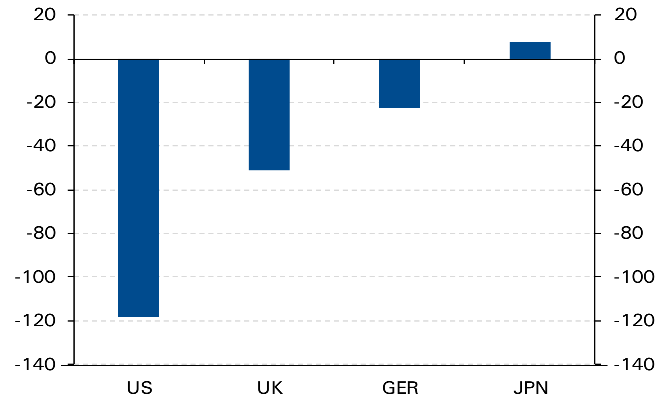
(%)



Source: Refinitiv, as of August 28

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

(basis points)



Source: Refinitiv, as of Aug 28

With subdued inflation, historically low policy interest rates, and an uncertain pace of economic recovery, we expect yields to remain subdued until higher certainty about a considerable economic pickup becomes visible, which depends on the longevity of the pandemic or the availability of a vaccine.

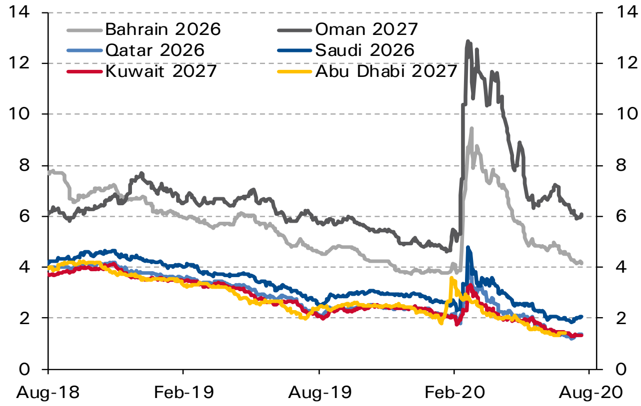
GCC yields trend downwards on relatively lower risks

GCC sovereign bond yields have trended downwards since April as investors priced in a less risky environment amid recovering oil prices and easing lockdown restrictions, leading to an improvement in economic activity, with the lower risk environment also reflected in a broad decline in credit default swap rates. (Chart 5.) The strong investor demand given the exceptionally low yields of global alternatives, has also helped push down GCC yields. Unlike their global counterparts, regional bond markets are considered relatively risky, and yields therefore tend to trend downwards when economic conditions improve, similar to other emerging market debt, as investors typically accept a lower risk premium in line with a lower risk environment. Regardless of yield changes, a positive spread is typically maintained between GCC and global yields, which usually becomes more pronounced during an economic downturn, reflecting the difference in credit and economic risk between developed and emerging markets.

The downtrend follows a sharp spike in yields in February/March that coincided with the twin economic shocks of crashing oil prices and the onset of the pandemic, which led to a deterioration of fiscal positions and increased the sovereign credit risk perceived by investors. (Chart 3.) The prior yield spike was especially high in GCC states deemed less credit worthy from a fiscal standpoint (Bahrain and Oman), such that they remain positive on a YTD basis even after declining significantly in recent months. (Chart 4.) In contrast, more resilient economies with higher creditworthiness were able to completely reverse prior yield increases, with Abu Dhabi, Kuwait, Qatar, and Saudi Arabian medium-term soverign yields down about 100 bps YTD on average.

Chart 3: Medium-term GCC sovereign yields

(%)

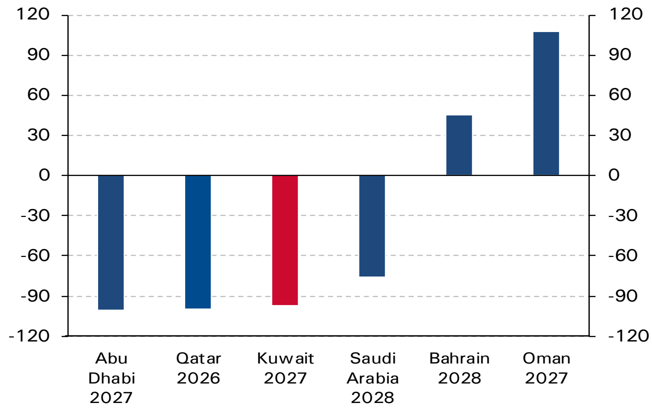


Source: Refinitiv, as of Aug 28

Looking forward, movements in GCC yields should be influenced by the longevity of the pandemic, oil market stability, and how swifly economies can recover. Should GCC fiscal and external balances remain under pressure from prolonged economic weakness or from possible credit rating downgrades, yields could drift higher. In contrast, an improvement in economic conditions may lower risk and ramp-up demand for regional paper, leading investors to accept lower yields (though a robust global economic recovery will probably push global yields higher which could have an impact on GCC yields).

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

(basis points)



Source: Refinitiv, as of Aug 28

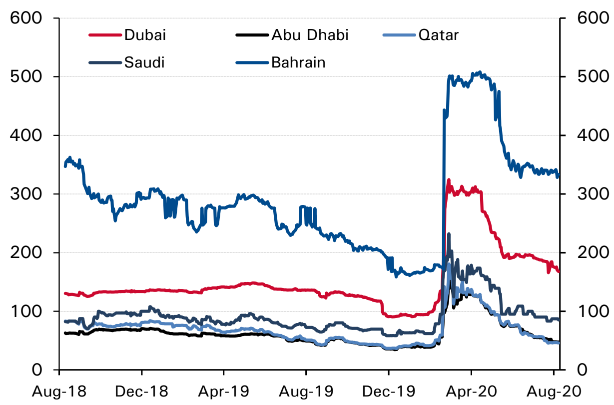
GCC issuance remains strong on higher financing needs

Regional debt issuance has been strong this year on higher financing needs arising from an extended period of low oil prices, the negative effect of the lockdown on economic output, and the subsequent strain on government budgets. International and domestic bond and sukuk issuance totaled about $58 billion in 1H20 ($77 billion in year to end 3Q, including scheduled issuances), compared to $62 billion issued in 1H19. A high financing (and refinancing) need has led to continued strength in issuance, in turn leading to a consistent increase in total regional outstanding debt,, currently standing at just under $563 billion, up 10% y/y. Given the relatively low cost and high need for financing amid mounting fiscal pressures, it is reasonable to expect that issuance will remain strong in the foreseeable future. The possible passing of a new debt law in Kuwait would also pave the way for the restart of issuance there in coming months.

GCC issuance so far in 2020 was dominated by sovereigns and quasi-sovereigns, the bulk of which stemmed from KSA ($32 billion) and the UAE ($26 billion) . (Table 1.) Notable issuance includes $4 billion in Eurobonds issued in May by Mamoura Diversified Global Holding, a UAE quasi-sovereign in 5, 10, and 30-year maturites; a $7 billion, three-tranche Saudi sovereign Eurobond issued in April and $9 billion in riyal-denominated Saudi sovereign sukuk with maturities ranging from 7-15 years. Also of note is a recent $5 billion sovereign Eurobond issuance by the UAE (Abu Dhabi).

Chart 5: Credit default swaps on GCC sovereign debt

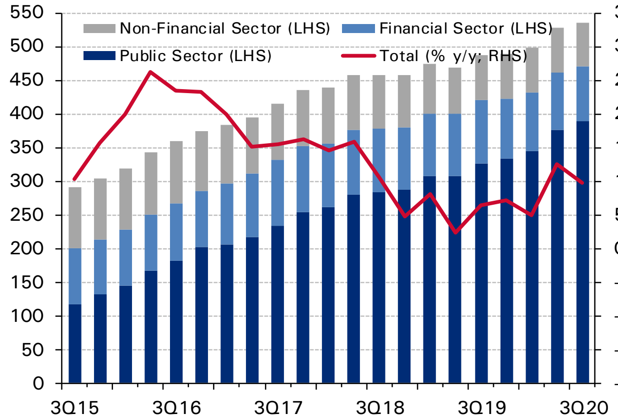
(Basis points)



Source: Refinitiv, as of Aug 28

Chart 6: GCC gross debt outstanding

($ billion)



Source: Refinitiv, as of Aug 28

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	16.8
Financial Sector	2.0	3.1	1.3	1.0	1.9	2.1	3.6	5.4	1.8	3.8	1.6	2.7
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	0.0
Total	**28.9**	**11.7**	**27.9**	**7.5**	**8.3**	**34.6**	**27.0**	**29.7**	**10.8**	20.4	37.7	19.4

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	0.7
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	0.5
Qatar	0.0	0.5	17.3	2.6	1.5	15.6	5.1	4.7	0.4	3.1	11.0	0.0
KSA	12.6	0.5	4.5	1.3	0.0	16.3	17.8	3.6	3.6	13.6	7.8	10.9
UAE	13.6	2.6	2.8	2.2	3.4	2.7	3.8	14.8	5.3	3.2	15.7	7.3
GCC	**28.9**	**11.7**	**27.9**	**7.5**	**8.3**	**34.6**	**27.0**	**29.7**	**10.8**	**20.4**	**37.7**	**19.4**

Source: Refinitiv, data as of August 28
*3Q20 figures include scheduled issuances.

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