Economic Update

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Debt markets

Global bond yields fell in 3Q amid growth concerns; GCC issuance remained solid

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Highlights

- **Global bond yields fell in 3Q19 on looser monetary policy and on economic growth and trade concerns.**
- **GCC bond yields saw even steeper declines in 3Q19 driven by bond index inclusion & strong demand from foreign investors.**
- **GCC bond issuance was solid at $30bn in 3Q19 led by UAE and Qatari sovereigns and local banks.**
- **GCC issuance will likely remain strong, supported by maturing debt, deficit financing, and low borrowing costs.**

Yields trend lower in 3Q19; GCC issuances solid

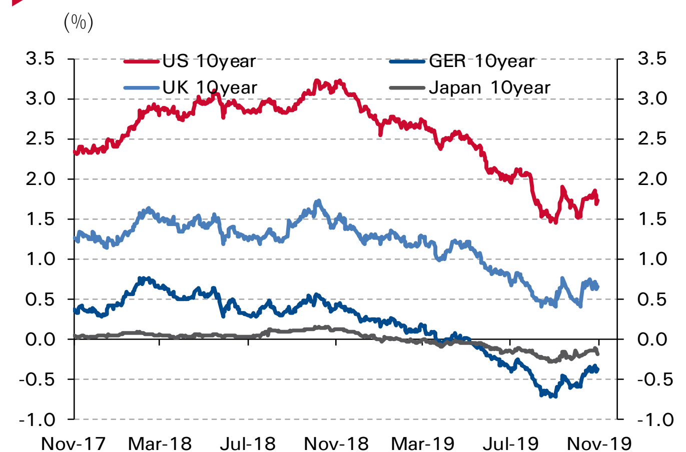
Weakening global economic growth, low inflation, central bank policy easing and lack of progress on the US-China trade dispute during 3Q19 saw global benchmark bond yields continue to trend lower during that quarter. GCC bond yields tracked their global counterparts, with even steeper declines despite rising geopolitical risk. GCC yields were impacted by policy rate cuts, solid demand for regional debt stemming from benchmark index inclusion, and relatively good risk-return profiles. Taking advantage of low borrowing costs and the favorable demand environment, GCC issuance was again solid in 3Q19, with total bond and sukuk issuance (both domestic and Eurobonds) amounting to $30 billion, dominated by sovereigns and local banks in the UAE and Qatar.

International yields continue to fall on trade and rate cuts

Global benchmark bond yields maintained a negative trajectory in 3Q19, underpinned by ongoing trade uncertainty, expansionary monetary policies, low inflation and sluggish economic growth. Further pressure came from the political side, with the developing impeachment inquiry of US president Donald Trump and ongoing Brexit uncertainty. The 3rd quarter saw two consecutive 25 bps rate cuts by the Federal Reserve (in July and September), which helped keep bond yields subdued, while the ECB unleashed fresh stimulus in September. The UK gilt yields saw the steepest quarterly decline, down 35 bps q/q, followed by US 10-year Treasury yields and German Bund yields, which decreased 33 bps and 24 bps, respectively. Japanese government yields were the least affected, down only 6 bps, but along with German Bund yields are now firmly in negative territory. Furthermore, it is noteworthy that the US yield curve is no longer inverted, with the recent rate cuts pushing down the short end of the yield curve and making its slope mildly positive.

As expected, a third Fed rate cut of 25 bps materialized in October bringing down the Federal Funds target range to 1.50-1.75%, but the Fed has adopted a more neutral stance going forward, signaling that the easing cycle might not continue and that the economy remains resilient. This statement came in the wake of a positive US jobs report, although business and manufacturing activity remain weak in the US and Europe. Market tensions also eased in October amid some positive developments on Brexit and the US-China trade front.

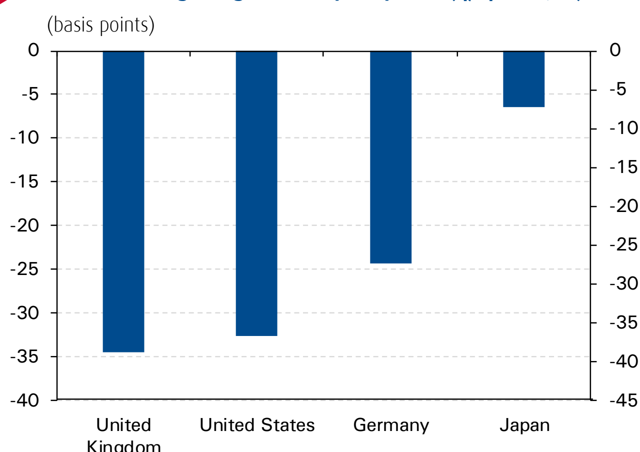
Chart 1: Global benchmark yields



Source: Refinitiv

The shift in sentiment curbed demand for safe havens and led to a rebound in stock markets. Against this backdrop, the US 10 year yield increased from a low of 1.5% in August to 1.7% in early November.

Chart 2: Change in global 10-year yields (q/q in 3Q19)



Source: Refinitiv

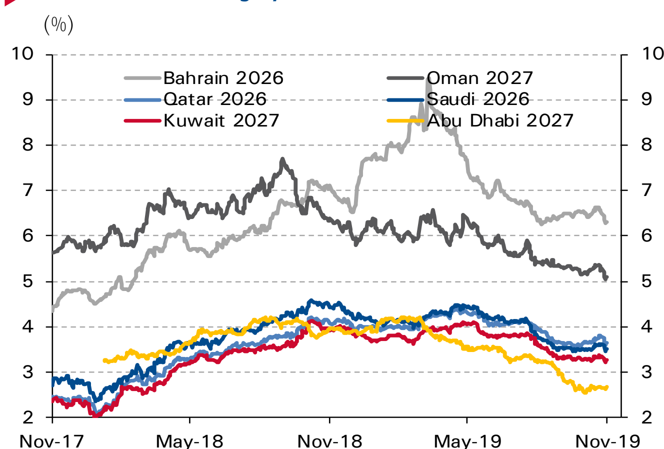
GCC yields saw steeper declines than international ones

GCC sovereign bond yields tracked their global counterparts lower in 3Q19, but with generally steeper declines. GCC yields were influenced by global factors including growth concerns, monetary easing, and trade negotiations uncertainty. However, the declines were compounded by other factors, mainly the large foreign inflows stemming from the inclusion of five GCC sovereigns (all but Oman) in the benchmark J.P. Morgan Emerging Markets Bond Index (EMBI) with an estimated $300 billion of assets under management benchmarked against the index. The inclusion process, which started in January 2019 and concluded in September, resulted in estimated foreign inflows of about $30 billion, given a weight of around 11% in the EMBI for the five GCC countries. These factors more than offset the yield-lifting impact of an increase in geopolitical risk following the September strikes on Saudi oil infrastructure.

Oman and Bahrain witnessed the sharpest declines in their sovereign bond yields, which decreased by 84 and 83 bps, respectively, as the two countries adopted reforms aimed at supporting fiscal consolidation. Indeed, recent reports point to a marked improvement in Oman's current fiscal standing and Bahrain is seemingly on track to eliminate its deficit by 2022. As a result, the yields on the new sovereign issuances of Bahrain and Oman in September and August respectively were lower than previous issues. Demand for Omani debt was probably helped by the launch of a new 'National Programme for Fiscal Balance', which could expedite fiscal consolidation by cutting spending and improving revenue collection. Meanwhile Kuwaiti sovereign yields in secondary markets declined 23 bps, in line with global and regional trends.

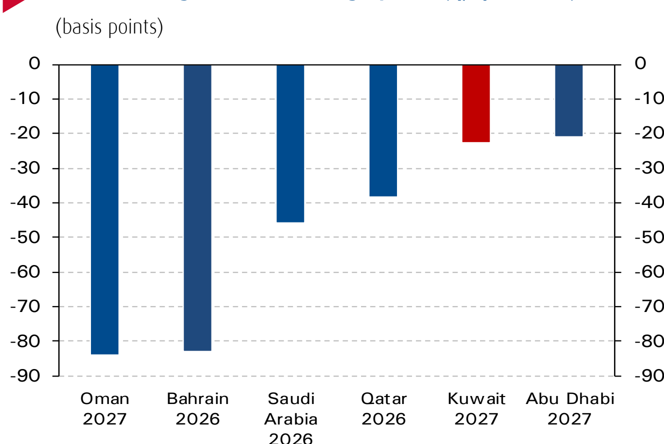
Going forward, GCC yields will probably continue to be influenced by global yields, which as mentioned above have moved lower in 3Q19 on growth and trade concerns. However, declines in GCC yields could be limited if slower global growth starts to impact oil demand, thereby exerting downward pressure on oil prices and implying larger GCC fiscal deficits and funding requirements. On the other hand, a further or sustained flare up in regional geopolitical tensions would most probably lift GCC yields.

Chart 3: GCC sovereign yields



Source: Refinitiv

Chart 4: Change in GCC sovereign yields (q/q in 3Q19)



Source: Refinitiv

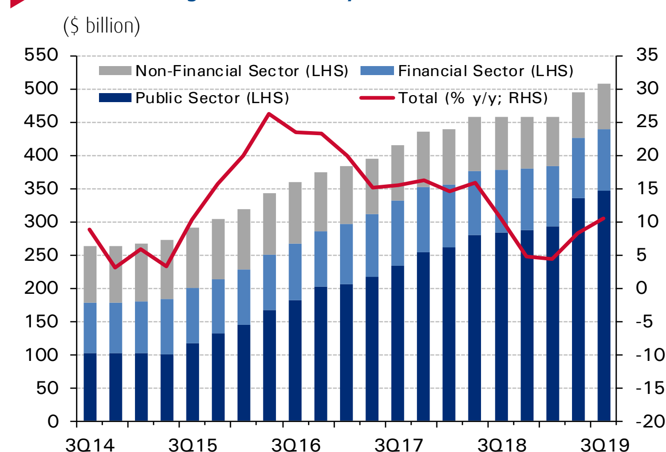
GCC issuance solid in 3Q19 amid low borrowing costs

GCC issuance (both domestic and international) in 3Q19 amounted to a solid $30 billion, of which around $2.3 billion were in Sukuk. Almost half of the issuances came from the UAE while over $4billion were issued by the Qatari government. Notable issuances in 3Q19 include Oman's $3 billion dual tranche Eurobond in August, tapping international markets for the first time in 18 months, and Bahrain's $2 billion bonds and Sukuk issuance in September, the first since the receipt of the GCC aid package last year. The Abu Dhabi government was the largest issuer by far, with a jumbo $10 billion, three-tranche Eurobond issuance in September with 5, 10 and 30 year maturities, while Saudi Arabia issued $3.3 billion in two parts in July. Total outstanding debt (domestic and international) rose to $514 billion at the end of Q3 from close to $500 billion in Q2.

Strong international demand for GCC debt driven by increasingly low and negative yielding debt in global debt markets, and the need for deficit financing have led to an extension of the strong issuance spree of 1H19 into 3Q19. Moreover, multi-year low yields continue to provide incentive for GCC governments to issue more debt, as well as a relatively large volume of maturing debt. Some $43 billion in bonds and Sukuk were scheduled to mature in 2019, of which $36 billion had already matured by the end of October. With these dynamics, we expect issuances to remain solid through the remainder of the year, with 2019 shaping up to be a strong year in terms of regional debt issuances.

Chart 5: GCC gross issuance by sector

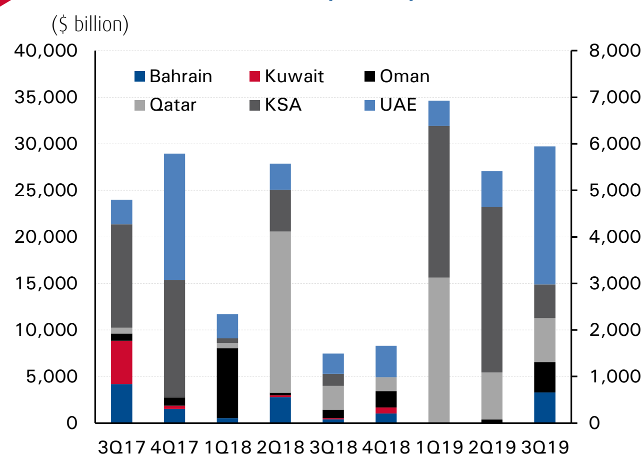
($ billion)



Source: Refinitiv

Chart 6: GCC new issuance by country

($ billion)



Source: Refinitiv

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