Virus uncertainty and bleak economic outlook weighs down on bond yields

**Highlights**

- Coronavirus effects and a contracting global economy have weighed down on global and some GCC bond yields.
- Some GCC yields fell on strong demand despite a muted economic outlook and fiscal strains from low oil prices.
- Omani and Bahraini debt, perceived as higher risk and less resilient to downturns, saw a surge in yields during 2020.
- GCC issuance totaled a solid $24 billion in 2Q20-to-date stemming from three sovereigns (Qatar, KSA, UAE).
- Yield prospects will depend on the longevity of the pandemic and the swiftness of the economic recovery.

**Coronavirus risks weigh down on global sovereign yields**

The coronavirus has had a severe impact on global growth and investor confidence in recent months. This, among other factors, has led to a heightened demand for risk-free assets, pushing down key global bond yields to historic lows. GCC sovereign bond yield changes were mixed, falling in Kuwait, Qatar, and Abu Dhabi on continued strong demand, despite risks associated with fiscal strains as a result of lockdowns and historically low oil prices. Noteworthy are three, well-received GCC sovereign issuances totaling a solid $24 billion in April alone, compared to $5 billion and $11 billion in 1Q20 and 4Q19 respectively.

**Global yields down on elevated risk and uncertainty**

Ongoing virus uncertainty, bleak economic data, low interest rates, and low inflation saw key global bond yields trend lower year-to-date. (Chart 1.) Declines were led by US 10-year yields, which fell by about 120 bps, followed by the UK 10-year gilt, down by around 60 bps. (Chart 2.) German yields, already in negative territory, fell less in comparison (30 bps), while Japanese yields were little changed. Looking forward, supply will be ramped up by higher issuance to finance major stimulus measures, which will help buoy yields. On the other hand, the ongoing virus uncertainty, renewed US-China tensions, low inflation and most importantly substantial central bank purchases, will likely keep yields subdued in the near term. Ultimately, yield movements will be influenced by the longevity of the pandemic and countries’ degree of success in reopening their economies.
GCC yields mixed, depending on creditworthiness

GCC sovereign yields were mixed as investors priced in varying country-specific risks from the impact of extended lockdowns and lower oil prices on fiscal positions. Governments deemed to be at a lower risk, i.e., those with stronger fiscal buffers, low debt-to-GDP ratios, solid credit ratings, and large reserves, saw continued demand, which kept their yields subdued. The drop in yields in these countries was also in part due to multiple interest rate cuts, coupled with a continued strong demand for prime GCC sovereign debt in these turbulent and uncertain times, given the alternative of low and even negative yields in some of their global counterparts. These countries were Kuwait, UAE (Abu Dhabi), and Qatar, where medium-term yields eased by 47, 40, and 26 bps YTD respectively, while Saudi yields were little changed. (Charts 3 and 4.)

On the other hand, sovereigns that are perceived by investors as less resilient from a fiscal and creditworthiness standpoint, namely Oman and Bahrain, saw a very steep rise in yields as investors sold-off in favor of less risky debt. Oman and Bahrain sovereign yields rose by a steep 300 and 400 bps respectively year-to-date.

Looking forward, movements in GCC yields will be influenced by how long the pandemic persists, how soon oil prices recover, and whether or not economic recovery will be swift. Should GCC fiscal and external balances remain under pressure from low oil prices, extended lockdowns or an unsuccessful reopening of economies, 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 rapid recovery could also push global interest rates higher). It seems however that risks are skewed to the downside for the time being (rising yields), as uncertainty about oil and the pandemic is still high.

GCC issuance and investor demand still strong

Despite the extended government lockdowns in place since March due to the coronavirus, GCC issuance has been relatively strong so far this year. Three dollar-denominated sovereign issues from Saudi Arabia, Qatar, and the UAE in April are noteworthy. The issuances totaled a solid $24 billion, bringing total sovereign bond issuance as of end of end of April to about $26 billion. The issuances were successful and significantly oversubscribed (about $140 billion in demand), suggesting that strong international demand for GCC sovereign debt is still strong. Of the $24 billion issued, Qatar issued $10 billion in three tranches with maturities ranging from 5-30 years, while Saudi Arabia and the government of Abu Dhabi issued $7 billion each, also in three tranches with maturities ranging from 5-40 years. The final pricing yields for the 10-year bonds were around 3.8%, 3.3% and 3.2% for Qatar, Saudi Arabia, and Abu Dhabi respectively, reflecting higher spreads over the respective US treasury yields. The higher risk is also reflected in a broad and marked rise in GCC credit default swap rates, typically used by investors to hedge against default. (Chart 5). Furthermore, more recently in May, Bahrain and Oman issued a total of $1.5 billion in bonds. Looking forward, we expect issuance to be strong this year on high financing needs due to oil and coronavirus fiscal pressures.
Chart 5: Credit default swaps on GCC sovereign debt
(Basis points)

Source: Refinitiv, as of May 12

Chart 6: Central bank policy rates
($ billion)

Source: Refinitiv
Head Office
Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ameen Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK

International Network
Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2816
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
68 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, UAE
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khaliqah 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

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 914279, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0441
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sarayeh
P.O. Box 11-5277, Ray El-Sabah
Bnut 1107 2200, Lebanon
Tel: +961 1 7259700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoun Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7392778/7191944
+964 1 7188046/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Mat 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

National Bank of Kuwait (International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7466 3677

France
National Bank of Kuwait (International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8680
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01 Republic Plaza
Singapore 048691
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1013, 10th Floor, Asia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

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