Economic Update

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Debt markets

Virus uncertainty and bleak economic outlook weighs down on bond yields

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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 issuances 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

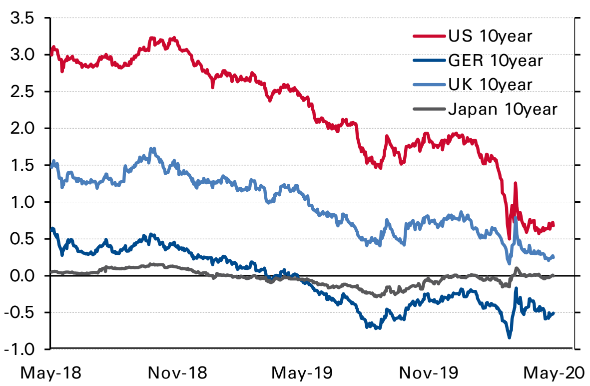
The coronavirus has had a severe impact on global growth and investor confidence in recent months. This, among other factors, has led to a heightened demand for risk-free assets, pushing down key global bond yields to historic lows. GCC sovereign bond yield changes were mixed, falling in Kuwait, Qatar, 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.

Chart 1: Global benchmark yields

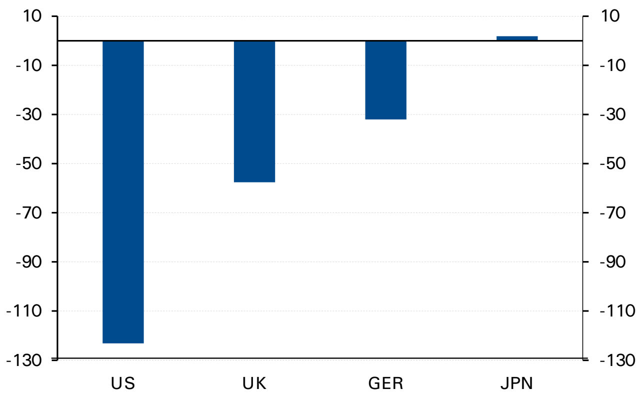
(%)



Source: Refinitiv, as of May 12

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

(basis points)



Source: Refinitiv, as of May 12

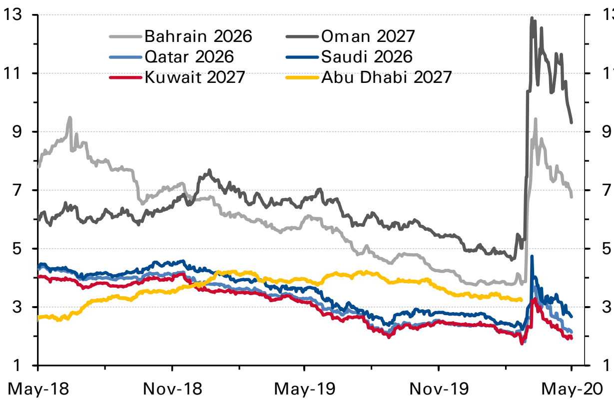
GCC yields mixed, depending on creditworthiness

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.

Chart 3: Medium-term GCC sovereign yields

(%)

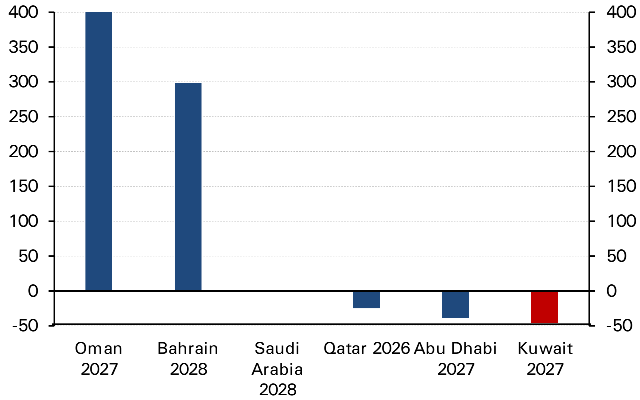


Source: Refinitiv, as of May 12

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.

Chart 4: Change in GCC sovereign yields (YTD)

(basis points)



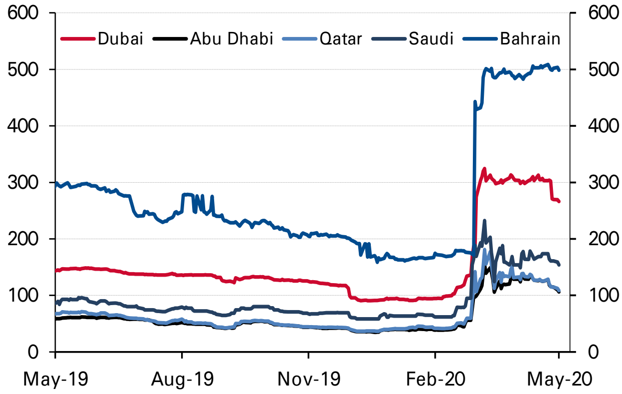
Source: Refinitiv, as of May 12

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

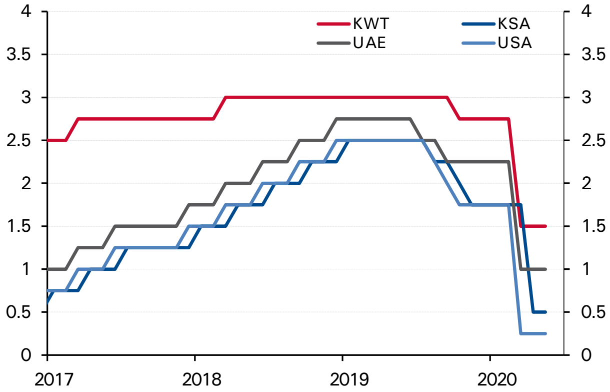
(Basis points)



Source: Refinitiv, as of May 12

Chart 6: Central bank policy rates

($ billion)



Source: Refinitiv

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