Economic Update

NBK Economic Research Department I 19 August 2019

Debt markets

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

> Daniel Kaye
Head of Research
+965 2259 3136,
Danielkaye@nbk.com

GCC debt issuance at record high in 2Q19, benchmark yields continue to fall

Highlights

- Global bond yields fell in Q2 (and further since) amid expectations of looser monetary policy and growth concerns.
- Regional yields saw even steeper declines in the second quarter helped by bond index inclusion.
- GCC bond issuance hit a record $40 billion in 2Q19 led by Saudi Arabia, dominated by sovereigns and quasi-sovereigns.
- Strong issuance in 2Q19 lifted total GCC outstanding debt to $501 billion, offsetting a large volume of maturing debt.

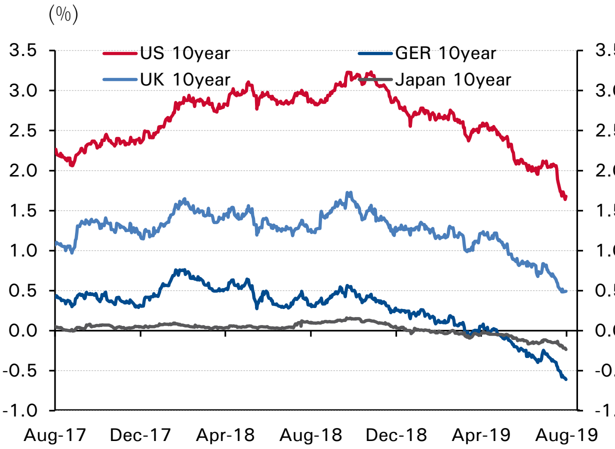
Yields trend lower in 2Q19, GCC issuance hits new record

Benchmark global bond yields continued to trend down in 2Q19 amid ongoing trade tensions, central bank dovishness and signs of slowing economic growth. GCC bond yields tracked their global counterparts lower and indeed saw steeper declines partly on increased demand due to EMBI index inclusions. Investors appeared to be relatively unswayed by recent geopolitical tensions in the Gulf, though a further escalation or alternatively falls in oil prices and revenues that jeopardize the fiscal situation pose a downside risk to GCC fixed income markets. Meanwhile, regional debt issuance hit a record $40 billion in 2Q19, dominated by sovereigns and quasi-sovereigns and led by Saudi Arabia.

International yields fall on trade, Fed rate cut

Ongoing trade tensions, weaker economic data, low inflation, and interest rate cut prospects saw benchmark global yields fall in 2Q19. (Chart 1.) The declines were led by US 10-year treasuries, which fell 41 bps q/q to 2.00% as of the end of 2Q. (Chart 2.) This resulted in a more pronounced yield curve inversion, with a spread of 12 bps between the 3-month and 10-year yields, which has since widened to 32 bps as 10-year yields sunk to a three-year low of 1.68% as of mid-August. A combination of low inflation and concern over the economic growth outlook due to trade factors could exert downward pressure on longer-term yields going forward, but Fed policy will also be key. While the central bank delivered a rate cut of 25 bps in July as expected, it also hinted that it might not be the start of a broader easing cycle. A more neutral Fed stance might cap further declines in US treasuries in the near-to-medium term, though futures markets are still pricing in at least one more interest rate cut this year given the escalating US-China trade dispute.

Chart 1: Global benchmark yields

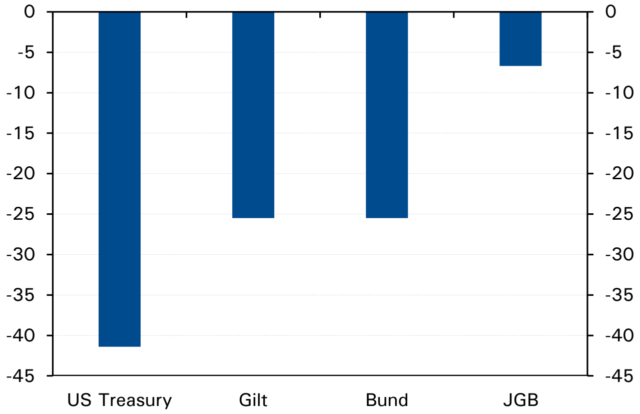


Source: Refinitiv

Meanwhile, weaker Eurozone growth, particularly declining manufacturing and exports in Germany due to the softer external climate, caused the 10-year German bund yield to cross into negative territory, declining 25 bps q/q to -0.33% as of the end of Q2 – lower even than Japan – and further to -0.61% by mid-August. Contributing to the decline, the European Central Bank has adopted an increasingly dovish policy stance, boosting the possibility of a rate cut and mulling the reintroduction of quantitative easing. UK gilts also suffered fairly steep declines (-25 bps to a record low of 0.5%), amid uncertainty surrounding Brexit and the resignation of prime minister Theresa May, replaced by Brexit hardliner Boris Johnson. Finally, Japanese JGB yields were the least affected by adverse global events, down only 7 bps q/q.

Chart 2: Global benchmark 10-year yields q/q in 2Q19

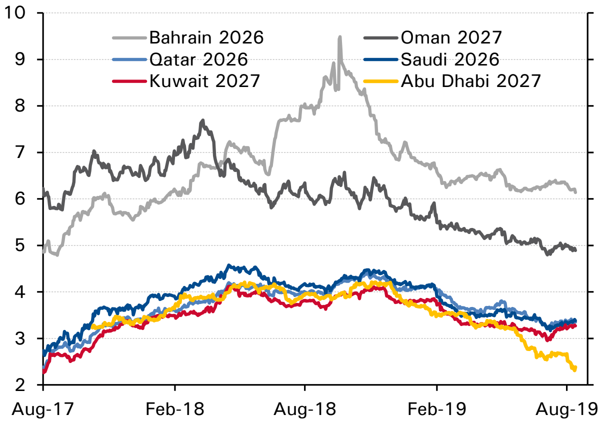
(basis points)



Source: Refinitiv

Chart 3: GCC sovereign yields

(%)



Source: Refinitiv

GCC yields see steeper declines

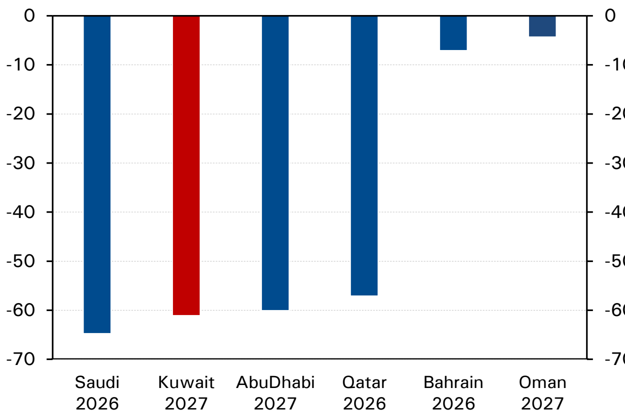
GCC yields on the whole saw steeper declines than their global counterparts, influenced by similar factors but also higher starting points for yields, Brent oil prices reaching above $75/bbl mid-quarter (though they have since fallen) and bond index inclusion (see below). Declines in medium-term (i.e. 7-8 year) GCC sovereign yields were led by Saudi Arabia, Kuwait and Abu Dhabi, down 65, 61, and 60 bps respectively in Q2. (Charts 3 and 4.) Demand for Saudi debt may have been boosted by Saudi Tadawul's launch of bond and sukuk trading in April, while the UAE debt market was helped by the enactment of a debt law in late 2018 and the establishment of a debt management office which has improved regulation, access and transparency for bond investors. Kuwait's decline in yields was helped by its strong credit rating and low existing debt levels, partly due to a lack of new issuance. Omani yields were the least changed, affected by delayed reforms and a challenging fiscal outlook relative to some GCC peers.

Regional demand has also been supported by the imminent inclusion of multiple GCC sovereigns in the JP Morgan Emerging markets Bond Index (EMBI). With $300 billion in assets under management and an assigned GCC weight of 11.3% in the EMBI index, the region is estimated to receive approximately $30 billion in fund inflows, with more than half going to the larger debt markets of Saudi Arabia and Qatar.

Looking forward, GCC yields will continue to be influenced by global yields, which as described above have moved lower on growth concerns. However, declines in GCC yields could be limited if weaker world growth causes oil prices to fall, implying larger fiscal deficits and funding requirements. A further or sustained flare up in regional geopolical tensions involving Iran could also underpin GCC yields.

Chart 4: GCC sovereign yields, q/q in 2Q19

(basis points)



Source: Refinitiv

Regional issuance hits fresh record in 2Q19

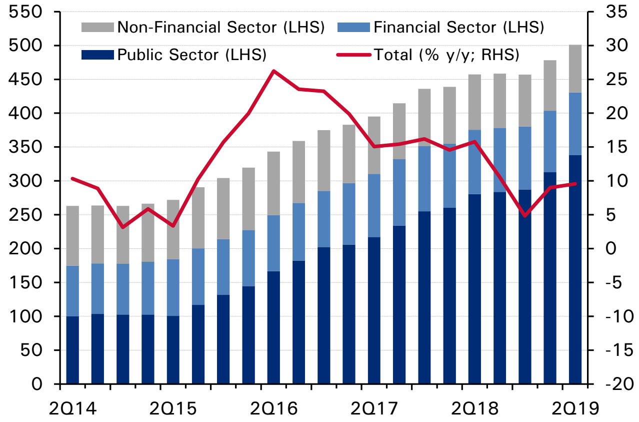
Amid lower yields, GCC bond issuance surged to a record $40 billion in 2Q19, breaking the previous high of $32 billion recorded in 1Q19 and paving the way for a strong year overall. (Table 1.) This lifted total outstanding debt (foreign and domestic) to $501 billion at the end of Q2 from $478 billion in Q1. (Chart 5.) Issuance was dominated by sovereigns and quasi-sovereigns, with funding for strategic investments by sovereign wealth funds and state-owned enterprises a strong driver. In addition, a large volume of maturing debt has likely helped ramp-up new issuance. Some $43 billion in maturing debt is scheduled for 2019, of which $28 billion had matured as of early-August.

The bulk of issuance in Q2 came from Saudi Arabia with $26.8 billion. This included a jumbo $12 billion from Saudi Aramco as it looks to foster relationships with international investors ahead of its IPO scheduled for 2021 and in light of its plans to purchase a stake in SABIC. Also of note, Oman tapped international debt markets for the first time this year in July, with a successful $3 billion issue despite concerns over its fiscal position. Meanwhile, a rise in issuance from the region's financial firms was supported by a reported surge in mergers and acquisitions, especially in the UAE and Saudi Arabia.

With global and regional borrowing costs already low and perhaps set to decline further, issuance could remain strong for the remainder of the year. Moreover, foreign investor appetite for regional paper remains solid, and GCC borrowing needs are supported by expansionary budgets and the recent drop in oil prices if sustained.

Chart 5: Outstanding GCC debt securities

($ billion)



Source: Refinitiv

Table 1: Gross GCC Issuance by sector (USD billion)

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Public	23.8	8.0	25.9	5.8	5.9	29.9	32.9
Financial	1.9	3.0	1.2	0.9	1.9	1.3	6.1
Non-financial	3.3	0.7	0.8	0.8	0.5	0.6	1.1
Total	**28.9**	**11.7**	**27.9**	**7.5**	**8.3**	**31.8**	**40.0**

Table 2: Gross GCC issuance by country (USD billion)

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
Bahrain	1.5	0.5	2.8	0.4	1.0	0.0	0.0
Kuwait	0.3	0.0	0.2	0.1	0.7	0.0	0.0
Oman	0.9	7.5	0.3	0.9	1.8	0.0	0.6
Qatar	0.0	0.5	17.3	2.6	1.5	15.6	5.9
KSA	12.6	0.5	4.5	1.3	0.0	13.6	26.8
UAE	13.6	2.6	2.8	2.2	3.4	2.6	6.7
GCC	**28.9**	**11.7**	**27.9**	**7.5**	**8.3**	**31.8**	**40.0**

Source: Refinitiv, Central Bank of Kuwait, press

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
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

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

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

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
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
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
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