GCC debt issuance strong in 1Q19, while global benchmark yields slide

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Highlights

- Global and regional yields trended lower in 1Q19 amid expected slower global growth and ongoing trade uncertainty.
- Low global inflation and dovish monetary policy have also weighed down on yields.
- GCC bond and sukuk gross issuance surged in 1Q19 by $32 billion, lifting outstanding debt to $478 billion.
- GCC issuance is expected to be solid in 2019 amid expansionary government budgets and refinancing needs.

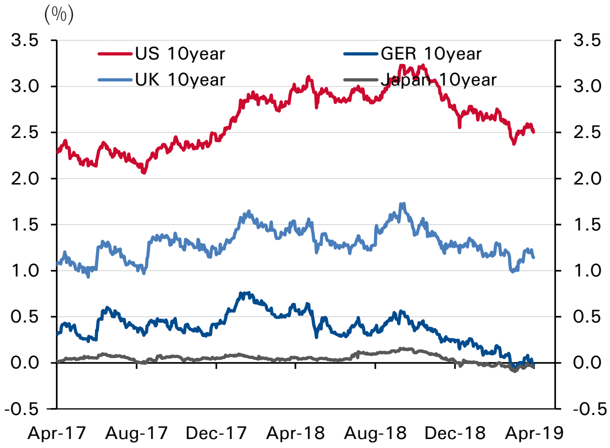
Yields trend down in 1Q19, GCC issuance at record high

Benchmark global bond yields trended lower in 1Q19 before edging slightly higher in April, against expectations of slower global growth, trade uncertainty, and dovish policy shifts by central banks in the US and Europe. Yields in the GCC tracked lower, helped by rising oil prices which have benefitted fiscal consolidation efforts. There was however a surge in regional debt issuance dominated by sovereigns in Saudi Arabia and Qatar, taking advantage of low borrowing costs, good credit ratings and strong appetite for regional paper among international investors. We expect regional yields to remain low this year given low policy rates and modest inflation, while regional issuance should increase after a modest 2018.

International yields decline on dovish policy signals

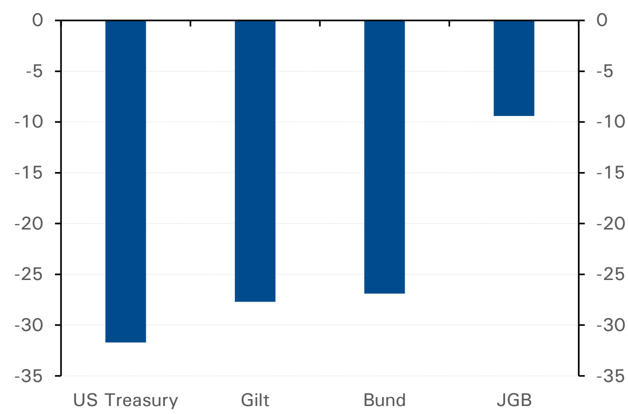
The slowdown in global growth, dovish signals on monetary policy, low inflation and trade war effects saw global benchmark yields continue to trend down in 1Q19. (Charts 1&2.) In the US, the 10-year treasury yield declined by 27 bps q/q to 2.41% at the end of Q1, close to its lowest in over a year, reflecting a lower growth outlook and growing anticipations that the US Federal Reserve would revert to cutting interest rates for the first time in over a decade later this year. This drop also resulted in the so-called inversion of the 10-year-three month yield curve – sometimes a signal of impending recession – although this inversion proved short-lived. Stronger economic data including above-consensus GDP growth in 1Q19, a fall back in inflation to well below the Fed's 2% target and also optimism on a US-China trade deal (which has since faded) scaled back expectations of a rate cut, helping to push the 10-year yield back up to 2.51% by end-April.

Chart 1: Global benchmark yields



Source: Thomson Reuters Datastream

Chart 2: Global benchmark 10-year yields q/q in 1Q19



Source: Thomson Reuters Datastream

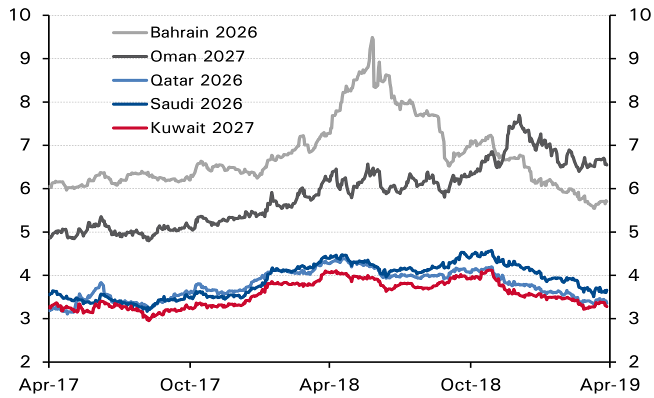
In the EU, political uncertainty (leadership changes, Brexit, political strife in Italy and France), low inflation and weak growth (exports, manufacturing) stemming from weaker global demand and detrimental US tariffs, caused European benchmark yields to also trend lower in 1Q19. The German Bund suffered the steepest decline among global benchmarks, losing 32 bps q/q. In contrast, Japanese sovereigns were the least changed in 1Q19, declining by less than 10 bps.

GCC yields also decline, helped by higher oil prices

GCC yields tracked their global counterparts lower in 1Q19 albeit with even steeper declines. The falls were led by Bahrain and Oman, which dropped by 95 and 90 bps q/q respectively despite continued pressure on fiscal positions. (Charts 3 and 4.) The drop in Bahrain sovereign yields was sparked by the provision of a $10bn support package by neighboring countries Kuwait, KSA, and UAE last year, of which $2.3 bn was recently disbursed, in tandem with a series of fiscal reforms undertaken by Bahrain, promoting a more positive outlook. Oman Yields also fell sharply partly due to the promise of fiscal reforms, namely VAT and excise tax implementation. All GCC sovereigns now have stable outlooks and most have investment grade ratings, except Oman and Bahrain. Yields across the GCC also likely fell due to the sharp recovery in oil prices from December lows, with Brent ending March at $68/bbl, up 27% q/q.

Chart 3: GCC sovereign yields

(%)



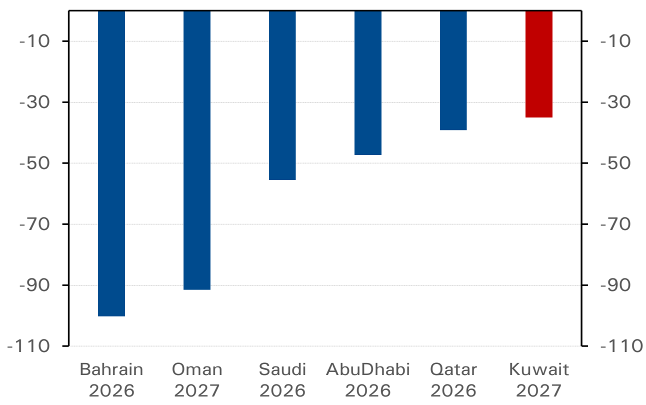
Source: Thomson Reuters Datastream

Various developments point to yields remaining low through 2019. Oil prices have continued to climb with Brent now above $70/bbl amid signs that the global oil market is tightening, affected by rising geopolitical tensions. This will support fiscal positions and may limit the potental increase in debt issuance in 2019. Meanwhile, the US Fed is unlikely to hike interest rates further this year (and could even cut if the US economy weakens), capping any potential rise in regional bond yields. However, opposing forces are at play; the recently escalating geopolitical risks in the gulf may apply upwards pressure on GCC yields in 2019.

International demand for GCC sovereigns is expected to receive a large boost this year due to the imminent inclusion of five (except Oman) GCC sovereigns in the JP Morgan Emerging markets Bond Index (EMBI). With $300 billion in assets under management allocated to this index by institutional investors, 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 KSA and Qatar.

Quarterly Change in GCC soverign yields

(basis points)



Source: Thomson Reuters Datastream

There has also been progress on the regulatory front, including the recent enactment of the UAE debt law (October 2018) and establishment of a debt management office. The Saudi Tadawul saw the launch of bond and sukuk trading in April. These developments should serve to improve debt management and regulation, transparency, market access, and availability of timely information.

Regional issuance strong in 1Q19, expected to remain solid throughout 2019.

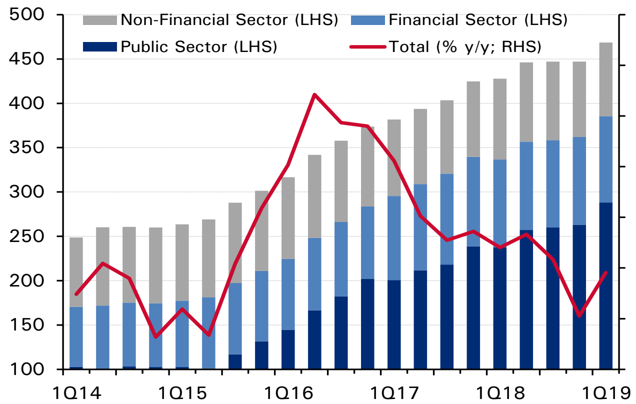
The pace of GCC debt issuance slowed in 2018, but rose sharply in 1Q19 to a historical high of $32 billion, resulting in a 9% y/y increase in outstanding debt to $478 billion. (Chart 5.) The debt issuance was dominated by Saudi and Qatari sovereigns and quasi-sovereigns which comprised over $29 billion. Also noteworthy is the debut issuance of $12 billion of Aramco bonds in April, oversubscribed by a very large margin reflecting strong investor appetite. The Aramco issuance is part of an additional $16bn in regional issuance scheduled for 2Q19. Moreover, Bahrain and Oman announced their intention to issue debt in 2019. With regards to Kuwait, issuance is expected to remain relatively low until the renewal of the public debt law, which expired in 2017. The law will enable the state to increase its debt ceiling to $25bn from a current $10bn.

Outside of the GCC, Egypt issued $4 billion in dollar-denominated bonds in February with maturities of 5, 10 and 30 years, in order to finance the state budget. The issuance was five times oversubscribed. Egypt also sold €2 billion worth of 6 and 12-year euro-denominated bonds in April. It does not plan to tap the international debt market again before the next fiscal year that begins in July.

The issuance of GCC sovereign bonds is expected to be solid in 2019 overall, despite rising oil prices and the boost to public revenues. This is due to largely expansionary budgets andrefinancing needs arising from maturing debt. Moreover, the cost of borrowing remains relatively low thanks to good credit ratings and slow US policy rate hikes, foreign investor interest is on the rise, and market access continues to improve.

Chart 5: Outstanding GCC debt securities

($ billion)



Source: Thomson Reuters Eikon, Press

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

	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19
Public	22.7	23.4	1.1	25.6	5.4	5.6	29.2
Financial	9.0	1.9	3.0	1.2	0.9	1.9	2.0
Non-financial	4.0	3.6	7.6	1.1	1.2	0.8	0.6
Total	24.0	28.9	11.7	27.9	7.5	8.3	31.8

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

	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19
Bahrain	4.2	1.5	0.5	2.8	0.4	1.0	0.0
Kuwait	4.6	0.3	0.0	0.2	0.1	0.7	0.0
Oman	0.8	0.9	7.5	0.3	0.9	1.8	0.0
Qatar	0.6	0.0	0.5	17.3	2.6	1.5	15.6
KSA	11.1	12.6	0.5	4.5	1.3	0.0	13.6
UAE	2.7	13.6	2.6	2.8	2.2	3.4	2.6
GCC	24.0	28.9	11.7	27.9	7.5	8.3	31.8

Source: Thomson Reuters Eikon, Central Bank of Kuwait, press

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