

GCC Fixed Income Market : 2018 - The Year That Was...

After three consecutive years of growth and record issuances in 2017, the GCC fixed income primary market took a breather, as bonds and sukuk issuances declined 14.1% in 2018 to reach USD 105.9 Bn. Government issuance during the year declined almost a third but was partially offset by almost 20% increase in corporate issuances. Issuances in the broader MENA region also declined during the year by 16% to USD 145 Bn as compared to USD 173 Bn during 2017 primarily due to lower bond issuances in non-GCC MENA countries.

The trends in the oil market had a visible impact on both government and corporate issuances in the region. The y-o-y increase in average oil prices in 2018 vs. 2017 supported state coffers, resulting in minimal external finance requirement to support the largely unaffected state spending plans, although the steep decline towards the end of the year prompted a more cautious and conservative outlook for the near term. According to KAMCO Research calculations and IMF data, deficits for the GCC region in 2018 are now forecasted to reduce to USD 14 Bn (-0.9% of GDP), an 82% reduction from 2017 budget deficits (USD 79 Bn), based on our analysis of IMF's general government fiscal balance estimates.

Corporate issuers in the region remained upbeat with higher bonds and sukuk issuances during the year. GCC corporates raised USD 47.2 Bn during the year via bonds and sukuk as compared to USD 39.5 Bn during 2017 with majority of them boasting a 'Stable' outlook from rating agencies. In addition, the volatility in the regional equity markets also favored higher issuances in the debt market. Firms took advantage of lower rates as the US Fed raised rates four times during 2018 and most of these rates were passed on by GCC regulators due to the pegged currencies for five out of the six GCC economies. On the other hand, the rising interest rates environment globally also resulted in lower returns for bond investors although the impact was blunted for the GCC instruments after GCC countries became a part of the JP Morgan Bond indexes during the year. The inclusion increased the demand for regional instruments by foreign investors.

In terms of sovereign ratings, majority of the GCC countries continued to boast an investment grade rating by the end of year with Abu Dhabi and Kuwait leading the pack. Recently, Oman's sovereign rating was downgraded by Fitch to a non-investment grade reflecting a widening of fiscal deficit to 10% of GDP in 2019 at an expected oil price of USD 65 per barrel, while the outlook for Bahrain was changed to Stable from negative.

Sovereign Credit Ratings

Country	Moody's	S&P	Fitch
Abu Dhabi	Aa2	AA	AA
UAE	Aa2	NR	NR
Bahrain	B2	B+	BB-
Kuwait	Aa2	AA	AA
Oman	Baa3	BB	BB+
Qatar	Aa3	AA-	AA-
Saudi Arabia	A1	A-	A+

Fixed Income Issuances in GCC (USD Bn)



Source: Bloomberg, KAMCO Research

Note: Bond and sukuk issuances in the report includes instruments with original maturity >1 year and Country of Domicile/Country of Risk is for the specified region.

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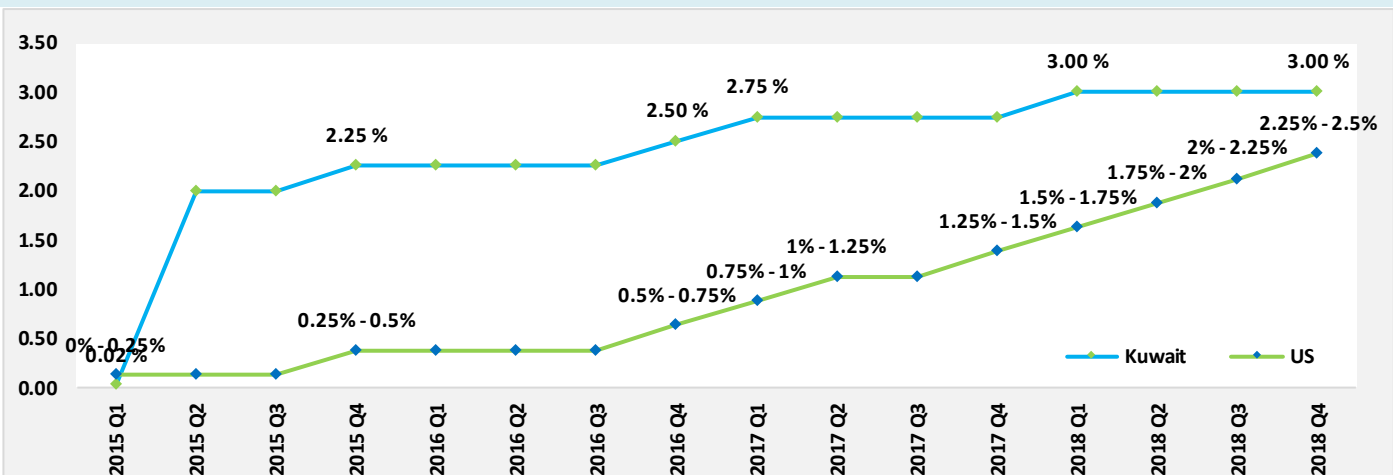
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US & MENA Rate Hikes

After a three rate hikes in 2017, the US Fed raised benchmark interest rates four times in 2018 and raised the rate by 100 basis points in four 25 bps steps to a higher range of 2.25% - 2.5%. Continued strong economic fundamentals in the US with expectations of a faster economic growth further backed by supportive employment and inflation data backed the rates hikes during 2018. However, expectations for 2019 was toned down while announcing the latest rate hikes with the committee now expecting two rate hikes in 2019 instead of a previous expectation of 3 hikes. The long-run funds rate expectations were also lowered from 3% in the September-18 forecast to 2.8% in the latest forecast. Expectations for 2019 were lowered to 2.9% from 3.1% while 2020 and 2021 estimates were lowered to 3.1% from 3.4% in the previous forecast.

Fed Fund Rate vs. Kuwait Central Bank Discount Rate

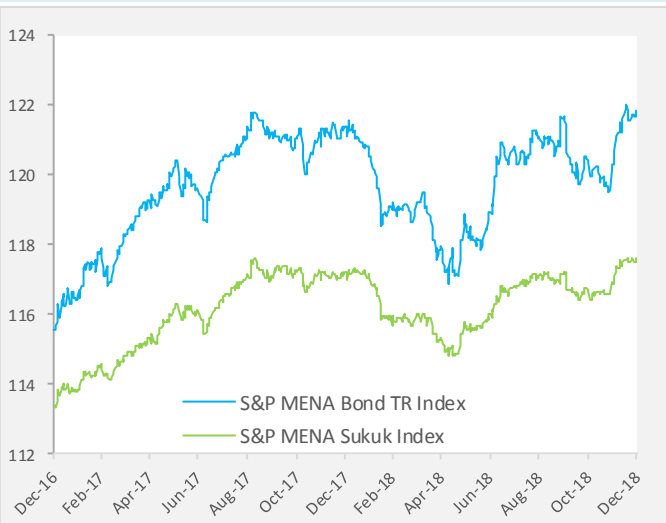


Data indicates end-of-period target rates/ranges. Source: US Federal Reserve, Central Bank of Kuwait, Bloomberg

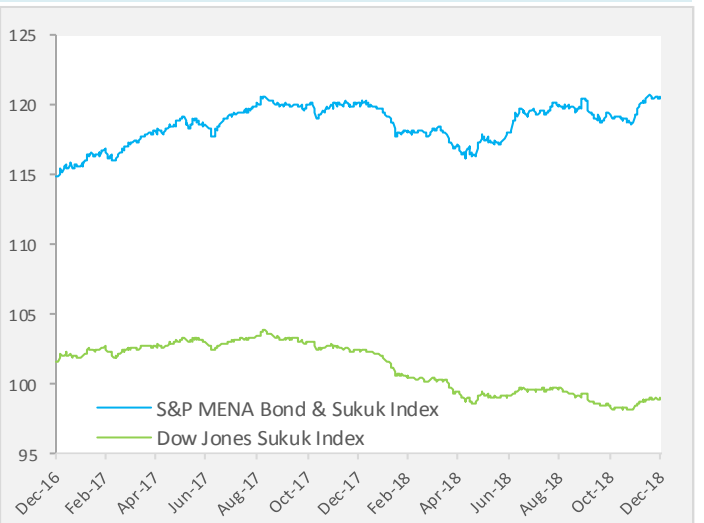
Rate hikes within the GCC were more differentiated with central banks using different tools in response to US rate hikes. Kuwait’s central bank kept its discount rate on hold after raising it in Q1-18 to 3.0% from 2.75% after holding it for a year. In response to the latest US rate hike, UAE central bank raised interest rates on certificates of deposit and repo rate for borrowing short-term liquidity by 25 bps. Bahrain’s central bank also raised its one-week deposit facility rate, the overnight deposit rate and lending rate by 25 bps to 2.75%, 2.5% and 4.5%, respectively. Saudi Arabia also raised repo rate and reverse repo rates to by 25 bps to 300 bps and 250 bps, respectively.

Fixed Income Market Performance

MENA Fixed Income Indices



MENA Vs. Global Sukuk Index

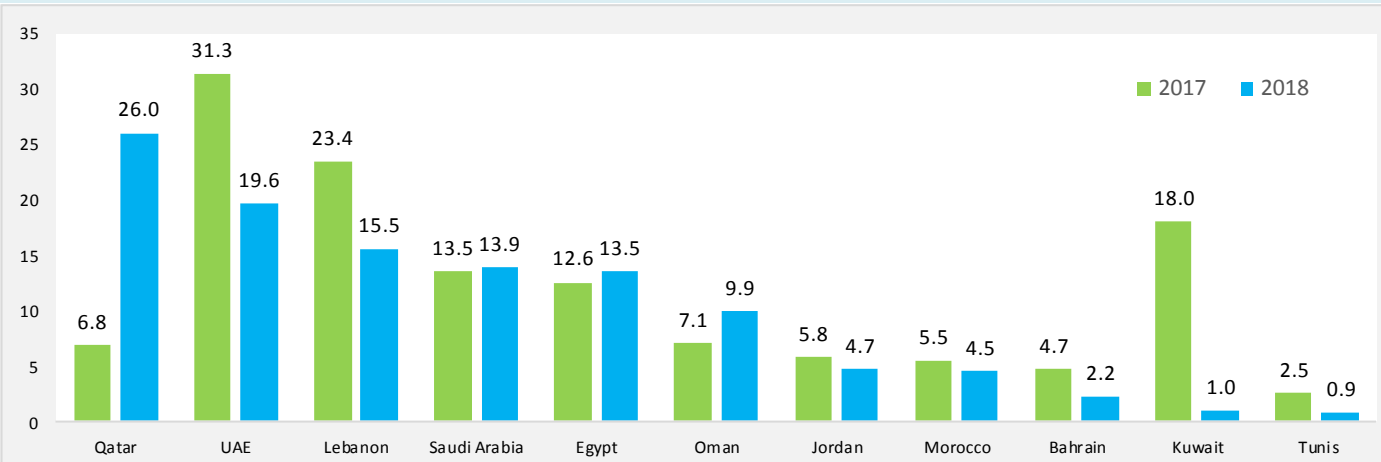


Source: Bloomberg, KAMCO Research

Regional fixed income indices mostly had a positive trend during the year while global fixed income indices declined in 2018. Although marginal, the MENA Bonds & Sukuk index gained 0.4% during 2018 while the benchmarks for the Global Investment Grade Debt and Global Sukuk declined by 1.2% and 4.1%, respectively.

MENA Bond Issuances

Bond Issuances (USD Bn) - 2018 vs. 2017

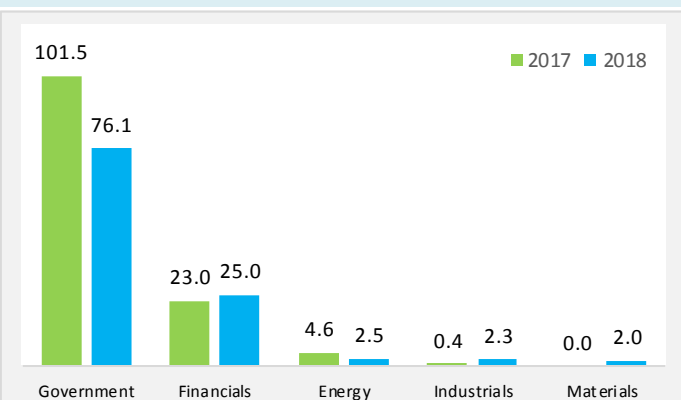


Source: Bloomberg, KAMCO Research

Bond issuances in the MENA region declined for the second consecutive year during 2018 led by a decline in issuances in both GCC and non-GCC MENA countries. In terms of type of issuer, government issuances declined by a quarter to reach USD 76.1 Bn in 2018 while corporate issuances increased by 19.8% to USD 35.5 Bn. Total bond issuance by GCC countries stood at USD 72.6 Bn, down 10.9% as compared to USD 81.4 Bn in 2017. Qatar was the biggest issuer during the year with total issuances increasing by almost 300% to USD 26 Bn in 2018 as compared to USD 6.8 Bn during 2017. The increase came primarily on the back of higher government issuances that jumped by almost 400% to reach USD 16.6 Bn in 2018 as compared to USD 3.5 Bn in 2017. Corporate issuances in Qatar also increased by 180% to USD 9.4 Bn in 2018, as compared to USD 3.4 Bn in 2017. UAE was the second biggest issuer with USD 19.6 Bn in total issuance during 2018, a steep decline from USD 31.3 Bn in 2017. The decline in UAE came primarily as the government almost completely pulled out of the primary market with merely USD 0.3 Bn in issuances during the year as compared to USD 10.0 Bn during the previous year. Corporates, on the other hand, remained active, but issuance declined by 9.5% to USD 19.3 Bn in 2018 as compared to USD 21.3 Bn during 2017. Saudi Arabia was the third biggest issuer in the GCC with USD 13.8 Bn in new issuances in 2018 a marginal increase of 2.9% from 2017. Issuances from Oman increased by 40% y-o-y as both the government and corporates took the fixed income route to fund investments. On the non-GCC side, Lebanon was the third biggest issuer in the MENA region with issuances totaling USD 15.5 Bn in 2018 a decline of almost a third as compared to USD 23.4 Bn during 2017. Issuances by Egypt increased 7.2% to 13.5 Bn, while Morocco issued USD 4.5 Bn in bonds, a decline of 17.4% as compared to 2017.

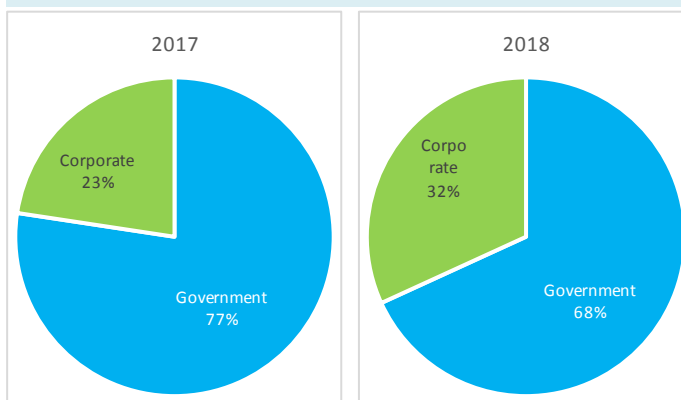
The forecast for bond issuances in the GCC remains upbeat, given the budget requirements of governments in the region, as they continue to spend on infrastructure while oil prices remain below historical levels. Saudi Arabia has indicated that it would issue USD 32 Bn in debt during 2019 in the international market to finance its budgeted deficits. Given the volatile equity markets and with oil price forecasted to remain subdued, we expect oil exporters in the GCC to increase bond issuances in 2019. Corporate issuances has increased for three consecutive years and with the project market and economic activity in the region expected to pick up, we expect higher corporate issuances from the region.

Top Five Sectors by Bond Issuance (USD Bn) - MENA



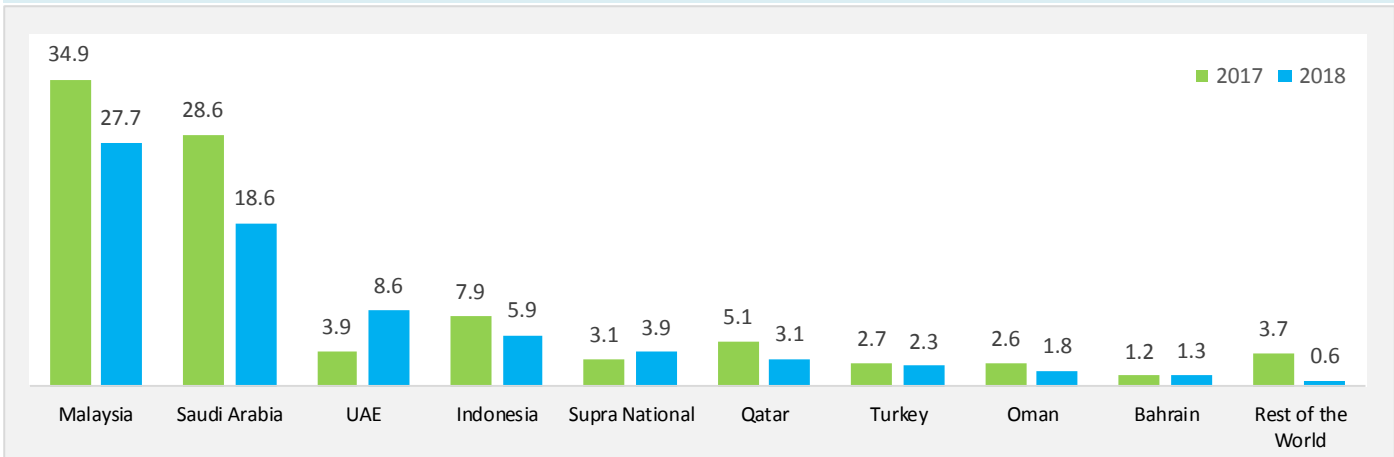
Source: Bloomberg, KAMCO Research

Breakdown by Issuer - MENA



Global Sukuk Issuances

Sukuk Issuances (USD Bn) - 2018 vs. 2017



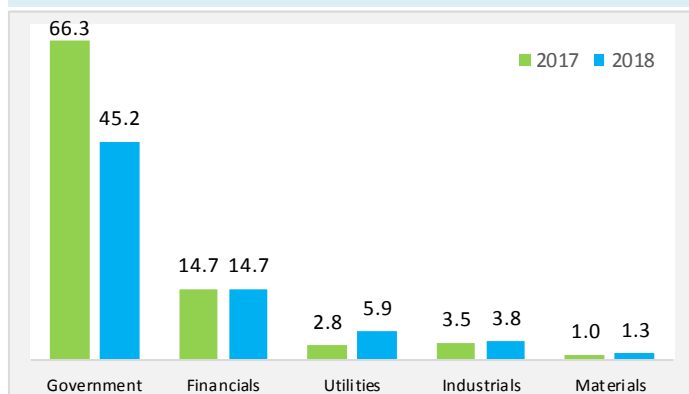
Source: Bloomberg, KAMCO Research

After two consecutive years of growth in 2016 and 2017, global sukuk issuances declined by 21.6% during 2018 to reach USD 73.7 Bn as compared to USD 93.7 Bn during 2017. The steep decline came primarily on the back of a 20.8% decline in issuances from Malaysia recorded at USD 27.7 Bn in 2018 as compared to USD 34.9 Bn in 2017. The decline in sukuk issuances by Saudi Arabia was even higher at 35.1% or USD 10 Bn, which drove the total lower to USD 18.6 Bn in 2018 as compared to USD 28.6 Bn in 2017. UAE was the only Islamic issuer to see more than doubling of sukuk issuances in 2018 that reached USD 8.6 Bn as compared to USD 3.9 Bn during the previous year. Issuances within the GCC totaled USD 33.4 Bn during 2018 as compared to USD 41.9 Bn during 2017, a decline of 20.3%.

In terms of type of issuers, global sovereigns continued to remain the biggest issuers of sukuk in 2018. However, sovereign issuances took a big hit in 2018 declining by almost a third to reach USD 45.2 Bn as compared to USD 66.3 Bn in 2017 led once again by relatively higher oil prices until Sept-18 that lowered funding requirements. On the other hand, corporates issuers once again remained strong during the year with an increase of 4.2% in sukuk issuances that reached USD 28.5 Bn in 2018 as compared to USD 27.4 Bn in 2017. Also, as seen in the case of bond issuance, GCC corporates remained active in the market increasing total issuance by 21.4% in 2018 to USD 12.0 Bn while GCC government sukuk issuances declined by 33.2% to USD 21.4 Bn. On the sectoral front, Financials continued to grab the lion’s share of total global sukuk issuances at USD 14.7 Bn, flat as compared to the previous year. Utilities and Industrial companies were next issuing USD 5.9 Bn and USD 3.8 Bn in sukuk during 2018, respectively.

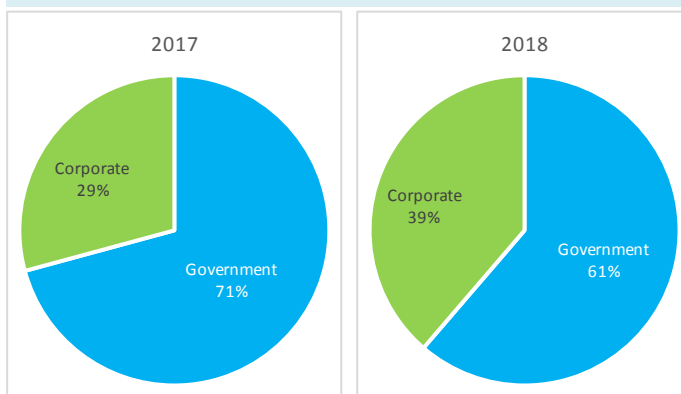
Sukuk issuances in the MENA region is expected to pick-up in the near term given the increasing popularity of Islamic instruments with an evolving and strengthening regulatory oversight and standardization. Moreover, regulators are also broadening the reach of sukuk to individual investors. For instance, Malaysia Securities Commission made it easier for retail investors to buy bonds and sukuk issued in the local market and has eased documentation requirements for issuers. Similarly, Nasdaq Dubai is also planning to allow retail investors to invest in sukuk market in 2019 and introduce retail sukuk instruments with minimal investment limit and Shariah compliant interest rate. In addition, the inclusion of GCC economies in the global bond index would be positive for the sukuk market and would attract capital from international investors looking at taking exposure to higher rated sovereign sukuk.

Top Five Sectors by Global Sukuk Issuance (USD Bn)



Source: Bloomberg, KAMCO Research

Breakdown by Global Sukuk Issuers



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