



GCC Fixed Income Chart Book: 9M 2018 Review

17th October 2018

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Welcome to our 9M 2018 chart book for the GCC fixed income market. The idea is very simple – to give those of you who follow this market a quick snapshot of some of the key points in terms of the following:

- Primary Market issuance in 2018 year-to-date and the new issue trend over the past eight years
- Market developments and relative value analysis
- Secondary Market performance of key instruments (snapshot from 29th December 2017 to 15th October 2018)

We have deliberately made the report text-light in an attempt to make it easier to digest. Hopefully you will find it both interesting and useful.

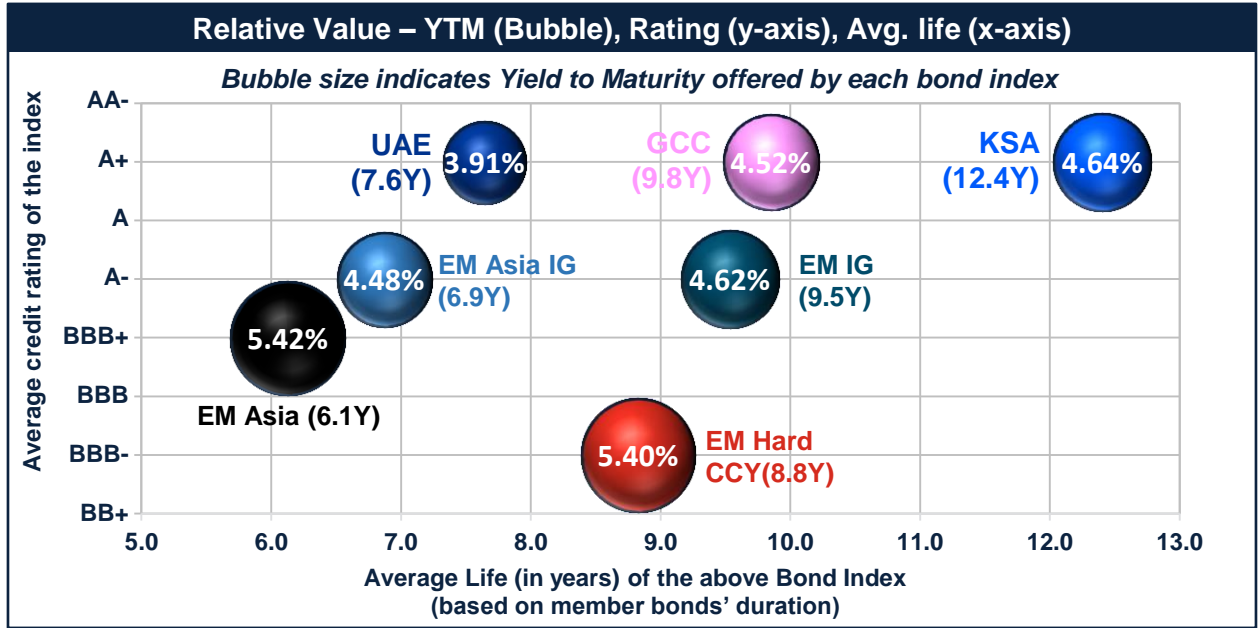
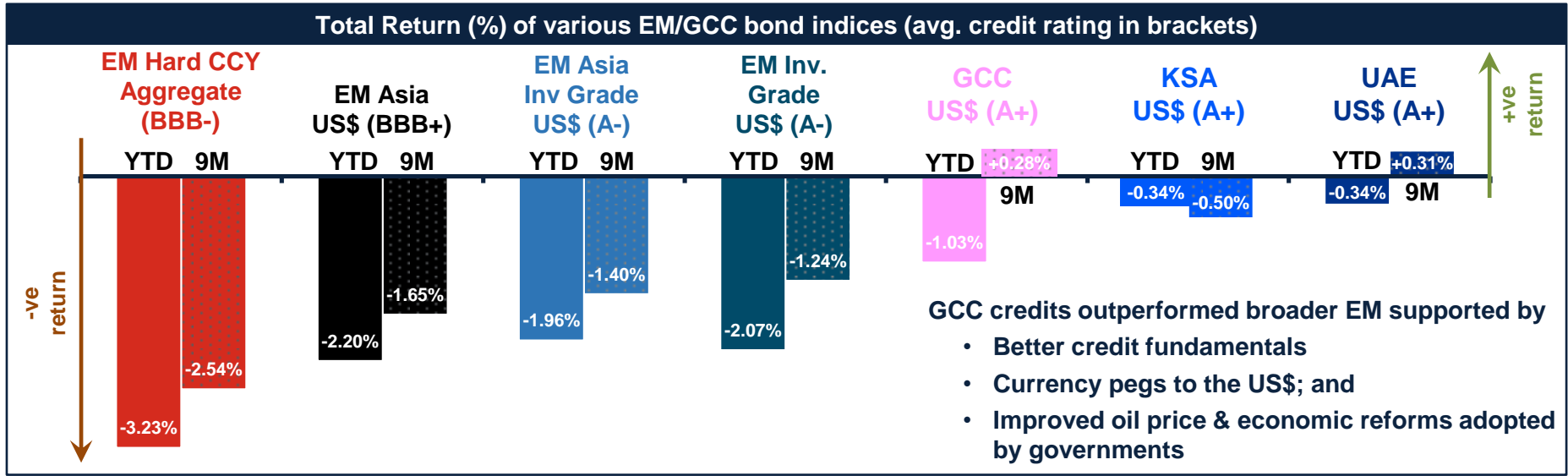
If you have any feedback on the report, or indeed would like to discuss any of the points highlighted, please do contact us.

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Relative Value: GCC, Asia & Broader Emerging Markets

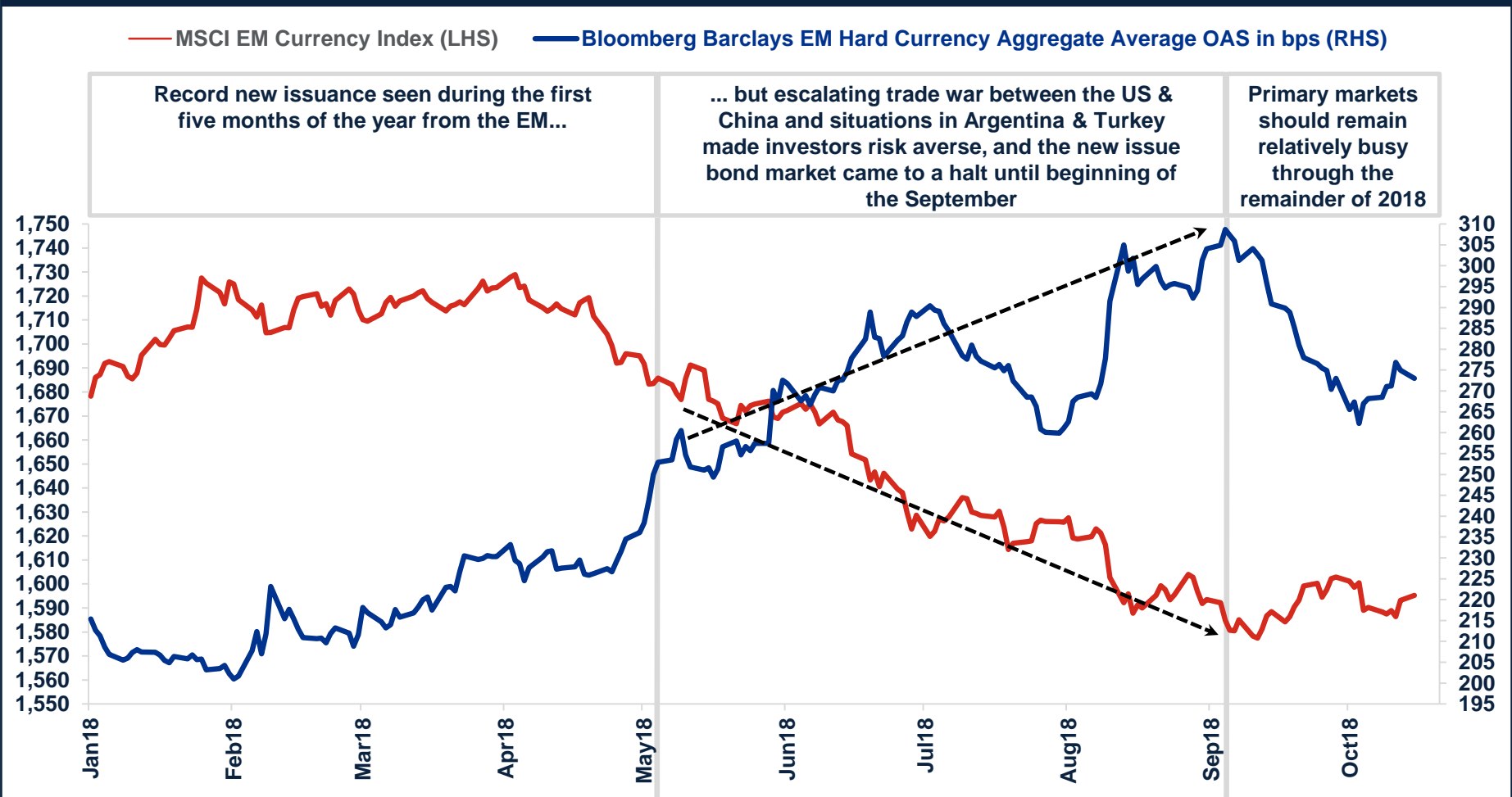


Geographic market	Bond Index (Bloomberg)
United Arab Emirates US\$ Aggregate	H20037US Index
Kingdom of Saudi Arabia US\$ Aggregate	I29134US Index
GCC US\$ Aggregate (6 nations)	BGCITRUU Index
Emerging Markets Inv. Grade US\$ Aggregate	BEHGTRUU Index
EM Asia Inv. Grade US\$ Aggregate	BEUGTRUU Index
Emerging Markets Asia US\$ Aggregate	BEUCTRUU Index
EM Hard Currency Aggregate	LG20TRUU Index

Source: Bloomberg/FAB

Headline risks kept markets under pressure during May-Aug, effectively shutting off EM/GCC primary issuance temporarily...

EM currencies and credit spreads took a beating



In the near-term, we see the following risks for GCC & EM credit markets that may deter investor appetite:

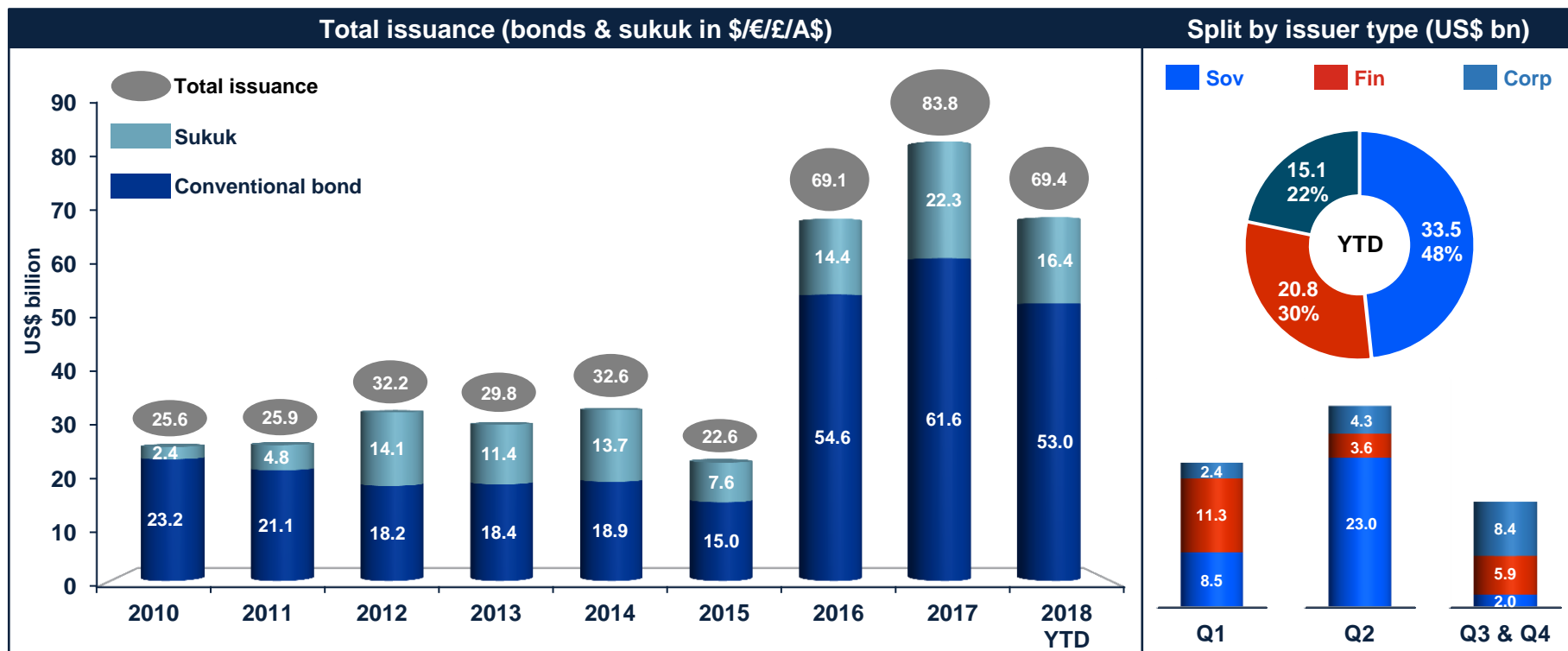
1. Any acceleration in the policy tightening trajectory from major central banks
2. Further escalation in US-China trade war
3. Any deterioration in regional geopolitics

Source: Bloomberg/FAB

...but GCC bonds & sukuk issuance was resurrected in September

The primary market in the GCC, since September this year, has been primarily dominated by corporate borrowers. We expect this trend to continue through rest of 2018, as we have highlighted earlier in our 1H 2018 report published in June.

Saudi Arabia once again tapped the Eurobond market in September and raised \$2bn through a long- 10-year Sukuk. Following the issuance, the Kingdom said the \$2bn Sukuk completed its external funding requirements for 2018. Bahrain and Oman have also said they will not return to the market before 2019. Other GCC sovereigns, with their strong balance sheet, are in a comfortable position to fund their budgets from internal resources and are not expected to return to the international bond market before the new year. In the absence of any major sovereign deals in the remainder of 2018, we expect the total new issuance volumes for this year to remain below the level seen in 2017.



In the above analysis we have considered major hard currency (\$/€/£/A\$) bonds and sukuk issuances from the six nations in the GCC. This includes both fixed and floating rate issuances of \$100m or above and maturity of 1-year or above.

EMBI inclusion and higher oil prices should support GCC credit spreads through higher levels of investment

Based on its Index inclusion criteria, JP Morgan in July this year announced that 5 GCC states – Saudi Arabia, the UAE, Qatar, Bahrain & Kuwait – will be added to its popular emerging markets bond index (EMBI). Bond inclusion will happen in a phased manner from the beginning of 2019.

Bond Inclusion Criteria

Bonds from Sovereign and 100%-owned quasi-sovereigns (GREs) should be eligible for inclusion, meeting the below criteria.

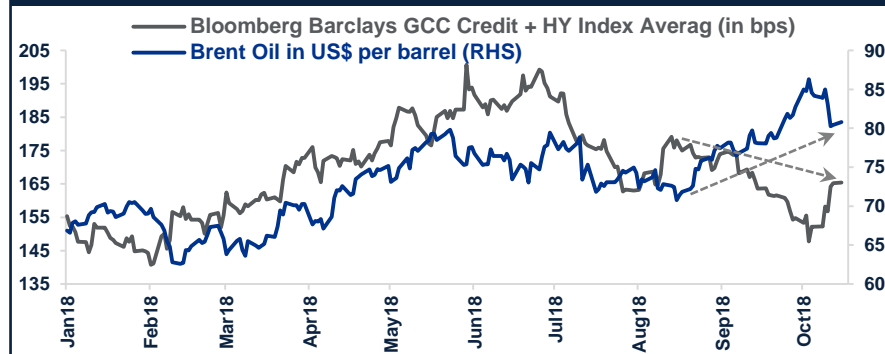
1. US\$ bonds with size of 500m or more; and minimum maturity of 2.5 years at the time of issuance
2. At least one year to maturity at the point of inclusion; subject to liquidity criteria
3. Unrated conventional bonds eligible if meeting criteria #1 & #2
4. Sukuk with at least one credit rating are also eligible, if meeting criteria #1 & #2

Bonds/Sukuk that we expect to benefit (Bloomberg tickers)

Abu Dhabi	ADGBs; MUBAUHs; INTPETs; ADNOUH; UNITYL 21
Dubai	DUGBs; DEWAAEs; DIFCAE 24; INVCOR 24; EMIRAT 25
Other UAE	SHARSKs; RAKS 25
Saudi Arabia	Sovereign bonds/sukuk (KSAs)
Bahrain	BHRAINs; OILGAS 27; MUMTAK 21
Kuwait	KUWIBs
Qatar	Sovereign bonds/sukuk (QATARs)

Note: Some bonds in the above list may not make it to the index, depending on criteria like liquidity etc; Source: FAB research & estimates; Bloomberg; JP Morgan

Brent oil price & GCC credit spread movement YTD



- While improved oil price helped strengthen the fundamentals of GCC Credits, the EMBI inclusion should act as additional catalyst for higher inflow of funds into GCC credits and thus support credit spreads in medium term.
- However, we also note that many EM investors already hold blue-chip credits from the region as part of their portfolios. Thus the incremental inflow arising from the index inclusion would of course be affected by this to some extent.

JP Morgan EM Global Diversified Bond Index (EMBIGD)

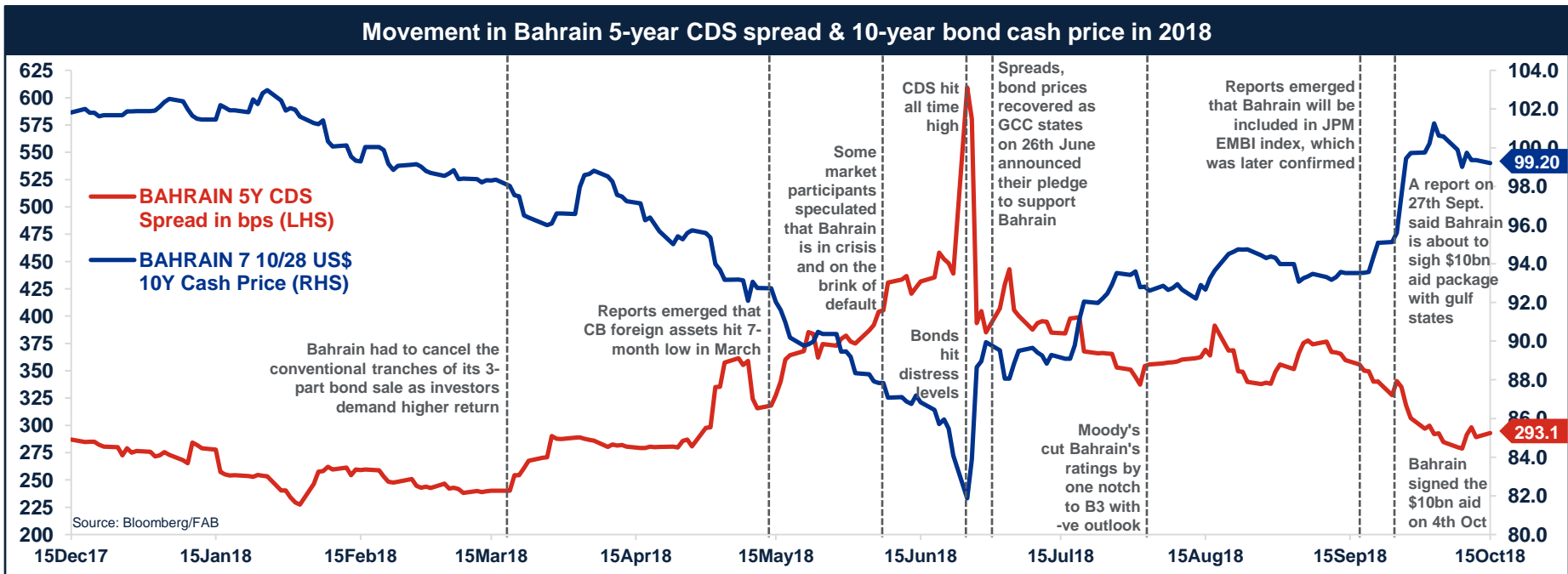
~\$300bn AUM benchmarked to EMBIG Index (conservative estimate)	GCC States to be included	Potential weight in the index	US\$ bn potential allocation (AUM*Weight)
	KSA	3.1%	9.3
	Qatar	2.7%	8.1
	UAE	2.6%	7.8
	Bahrain	2.1%	6.3
	Kuwait	0.8%	2.4
Total GCC FI	11.3%	33.9	

Bahrain, battered in Q2, turned out to be one of the best performing sovereign credits in EM this year

Bahrain sovereign bonds emerged as the biggest winner in past few weeks in the GCC fixed income universe. Indeed, from one of the worst performing EM sovereign credits in Q2, Bahrain is now one of the best performing sovereigns so far this year. On 11th June, we published a note, “Bahrain: Battered but not broken”, where we highlighted some of the key issues Bahrain is facing and the drivers behind the sell-off. We also highlighted our base case in the report that the sovereign would likely receive necessary financial support from its GCC neighbours, when required, notwithstanding the fact that Bahrain still needs to find sustainable longer term solutions in terms of its macroeconomic situation.

The recovery in Bahrain’s bonds could primarily be attributed to three main factors: (1) The announcement towards the end of June that Saudi Arabia, Kuwait and the UAE would soon announce an integrated program to support Bahrain; (2) JP Morgan’s statement (on 26th Sept) that it will include Bahrain in its emerging markets bond index; and (3) Reports emerging (on 27th Sept) that Bahrain would sign a \$10bn 5-year aid package with Gulf states, which was later officially confirmed on 4th October.

Cash prices of Bahrain bonds pushed higher across the curve starting 26th September. Gains through 26th Sept to 4th Oct were in the range of 2-8 points on the sovereign curve. We thus saw some profit taking in last few trading sessions, which was expected. In the chart below we have highlighted the key points of Bahrain’s performance so far this year.

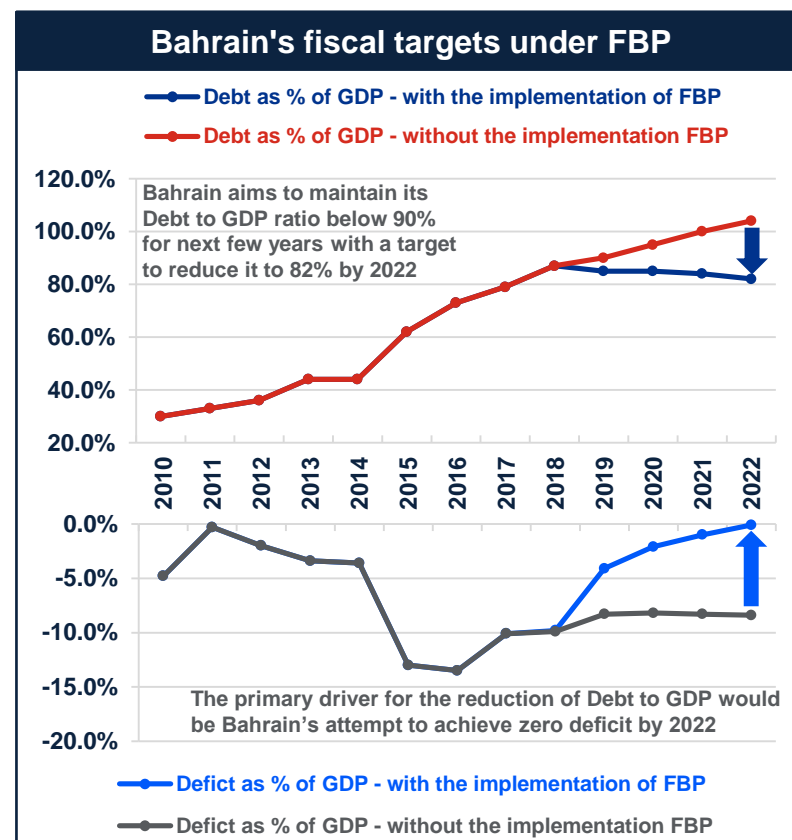
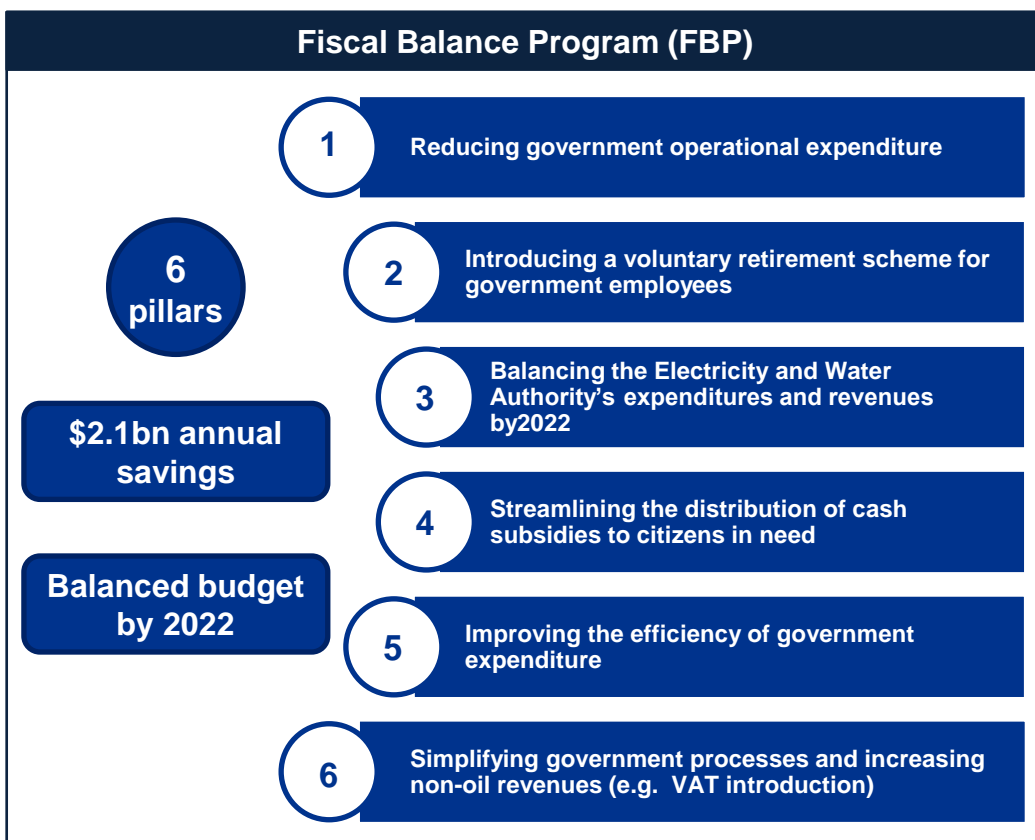


\$10bn support is part of Bahrain's Fiscal Balance Program

The \$10bn 5-year aid package that Bahrain secured from Saudi Arabia, Kuwait and the UAE on 4th October is attached to a Fiscal Balance Program (FBP) that Bahrain announced with an aim to balance its budget by 2022.

The three gulf states will contribute equally to the package over the next five years (2018-22), subject to regular review of the progress under FBP. The Arab Monetary Fund (AMF) will act as the program consultant to monitor the progress.

As part of the Fiscal Balance Program, Bahrain has already started initiatives to implement Value Added Tax (VAT) at the beginning of 2019. VAT is one of the 6 pillars Bahrain aims to implement and would be the major contributor to the government's non-oil revenues.

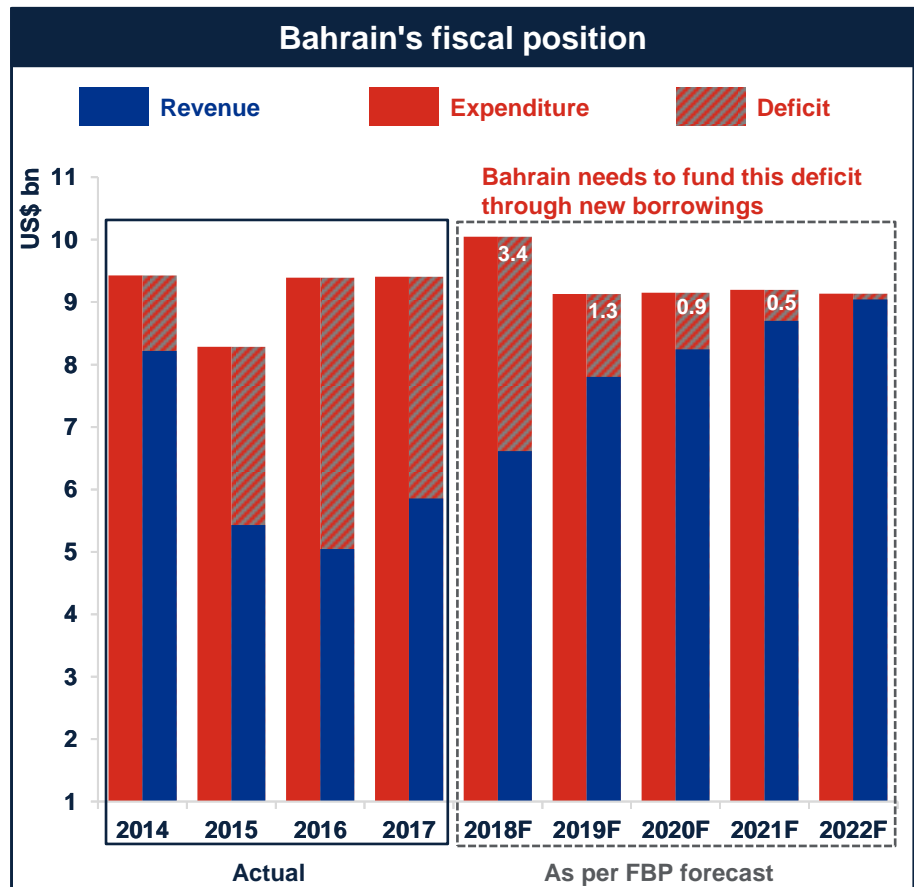
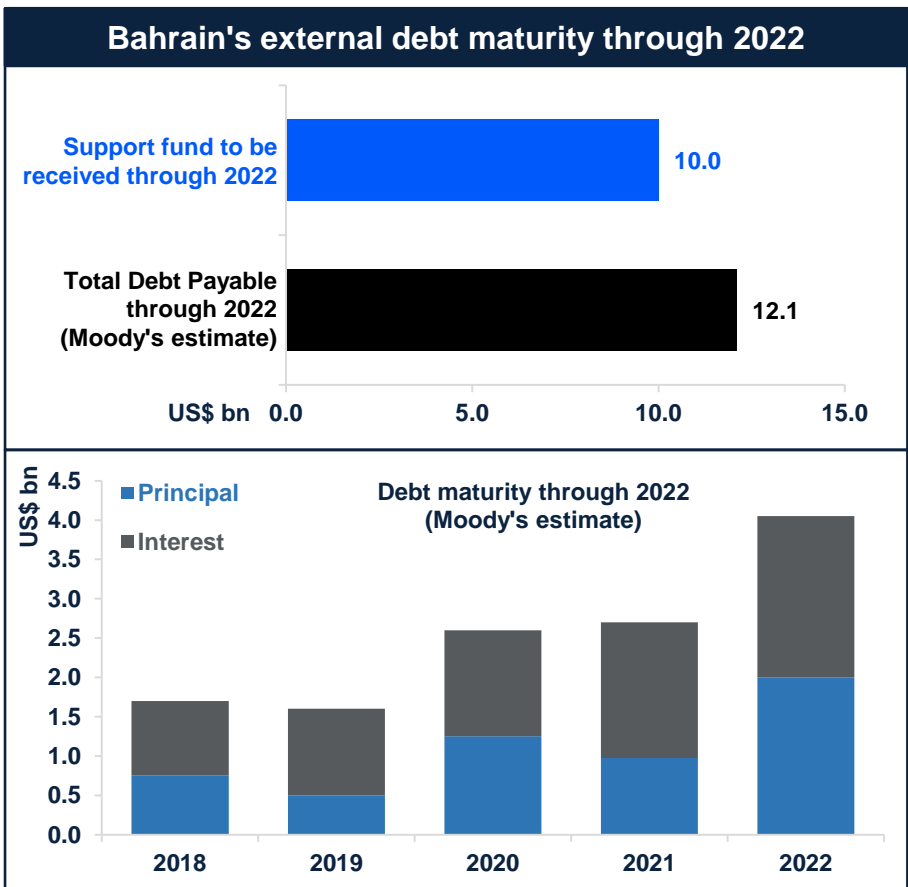


Source: Fiscal Balance Program document released by Government of Bahrain; FAB; Bloomberg

Overall, the developments on the Bahrain story are credit positive

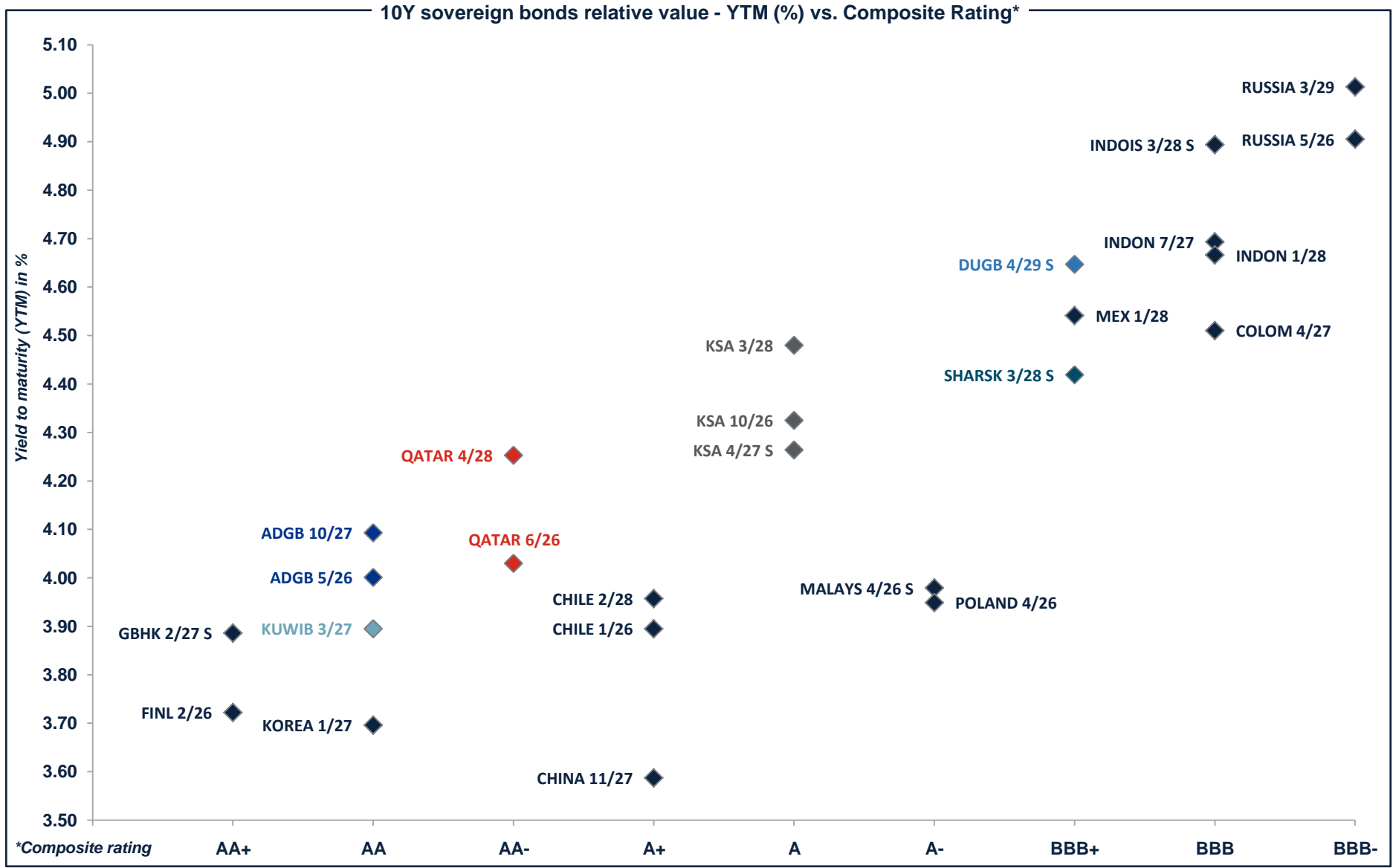
The support fund alleviates Bahrain's credit risk overhang in the near-term and should help Bahrain return to the debt capital market next year. While the \$10bn in aid should help Bahrain meet its debt maturity through 2022 – estimated at \$12.1bn by Moody's – the sovereign still needs to raise external borrowings to fund its budget deficit through 2022.

Net net, the developments are credit positive for the sovereign and for the GCC fixed income market per se, however investors should now pay close attention to Bahrain's reform initiatives and more importantly the execution of these, which in our opinion would affect the sovereign's borrowing cost in its forthcoming new debt issues.



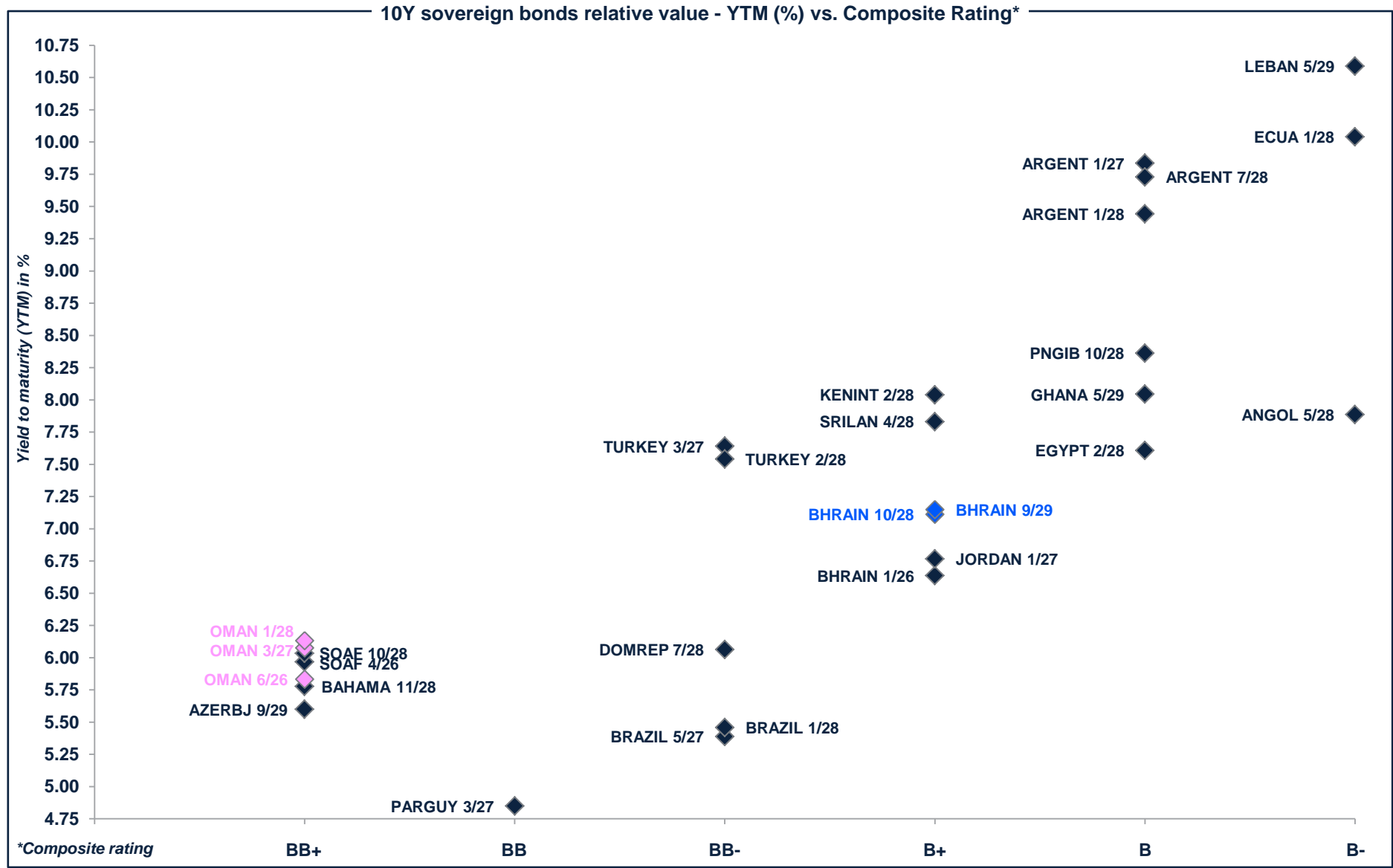
Source: Fiscal Balance Program document released by Government of Bahrain; Data from Central Bank of Bahrain investor presentation and Ministry of Finance data library; Moody's report on Bahrain dated 9th October 2018; FAB; Bloomberg

GCC inv. grade sovereign bonds vs EM peers – 10Y relative value



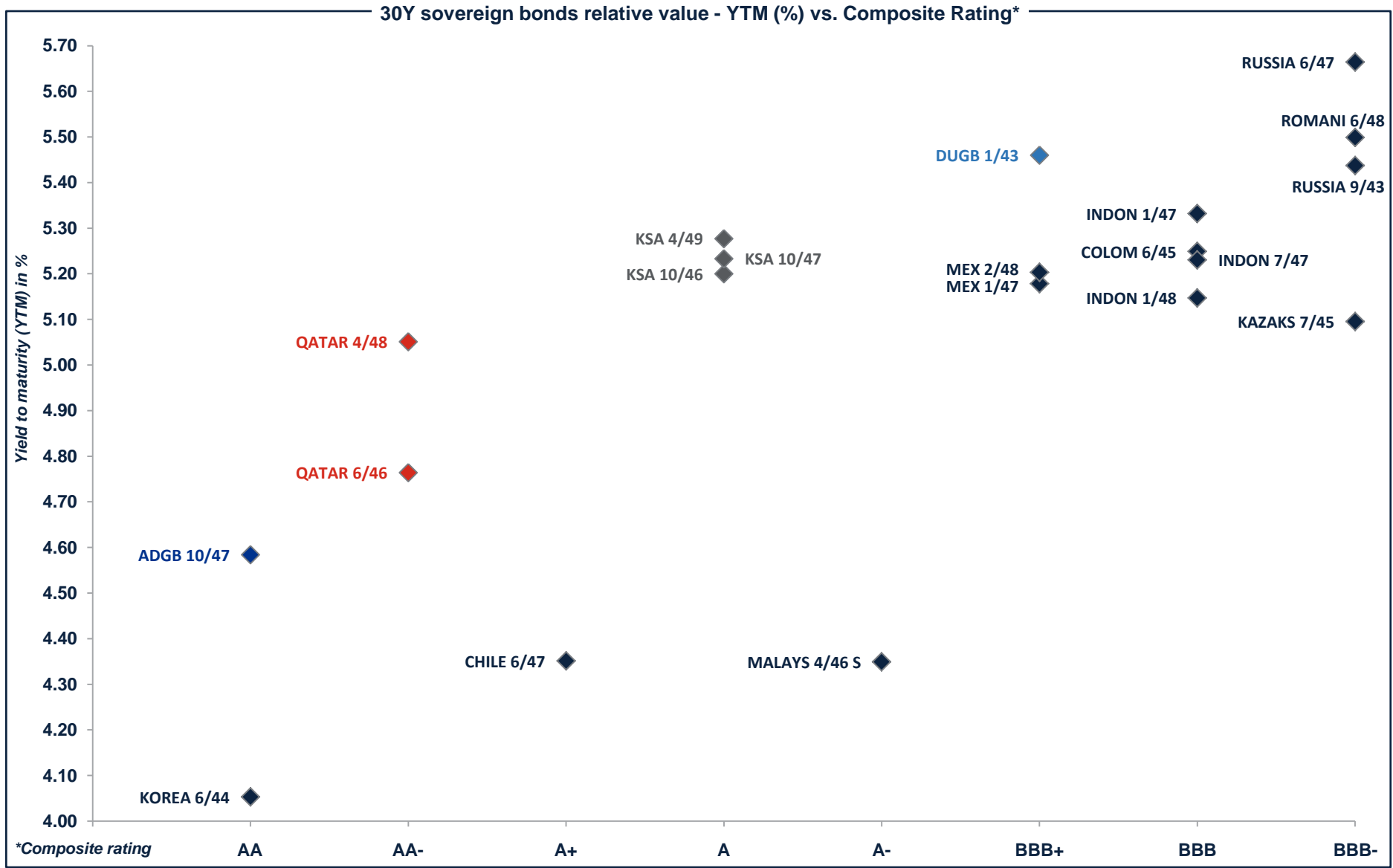
* Notes: Yields as on 15-October -2018; Composite rating - please refer Appendix for definition and calculation method; Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to Emirate of Sharjah (BBB+) and Dubai GREs like DP World (BBB+) and DEWA (BBB) Source: Bloomberg/FAB

GCC sub-inv. grade sovereign bonds vs EM peers – 10Y relative value



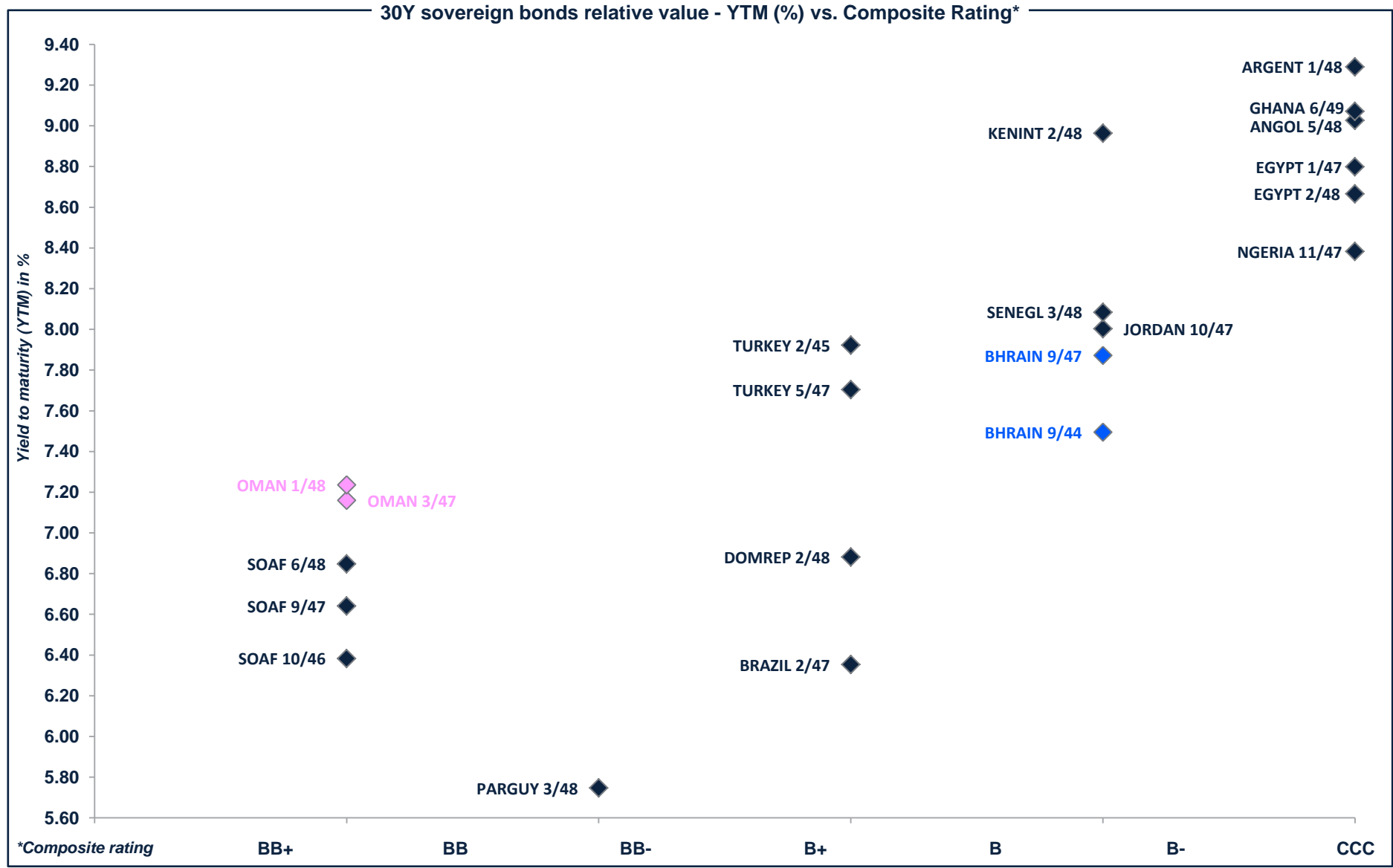
* Notes: Yields as on 15-October -2018; Composite rating - please refer Appendix for definition and calculation method; Source: Bloomberg/FAB

GCC inv. grade sovereign bonds vs EM peers – 30Y relative value



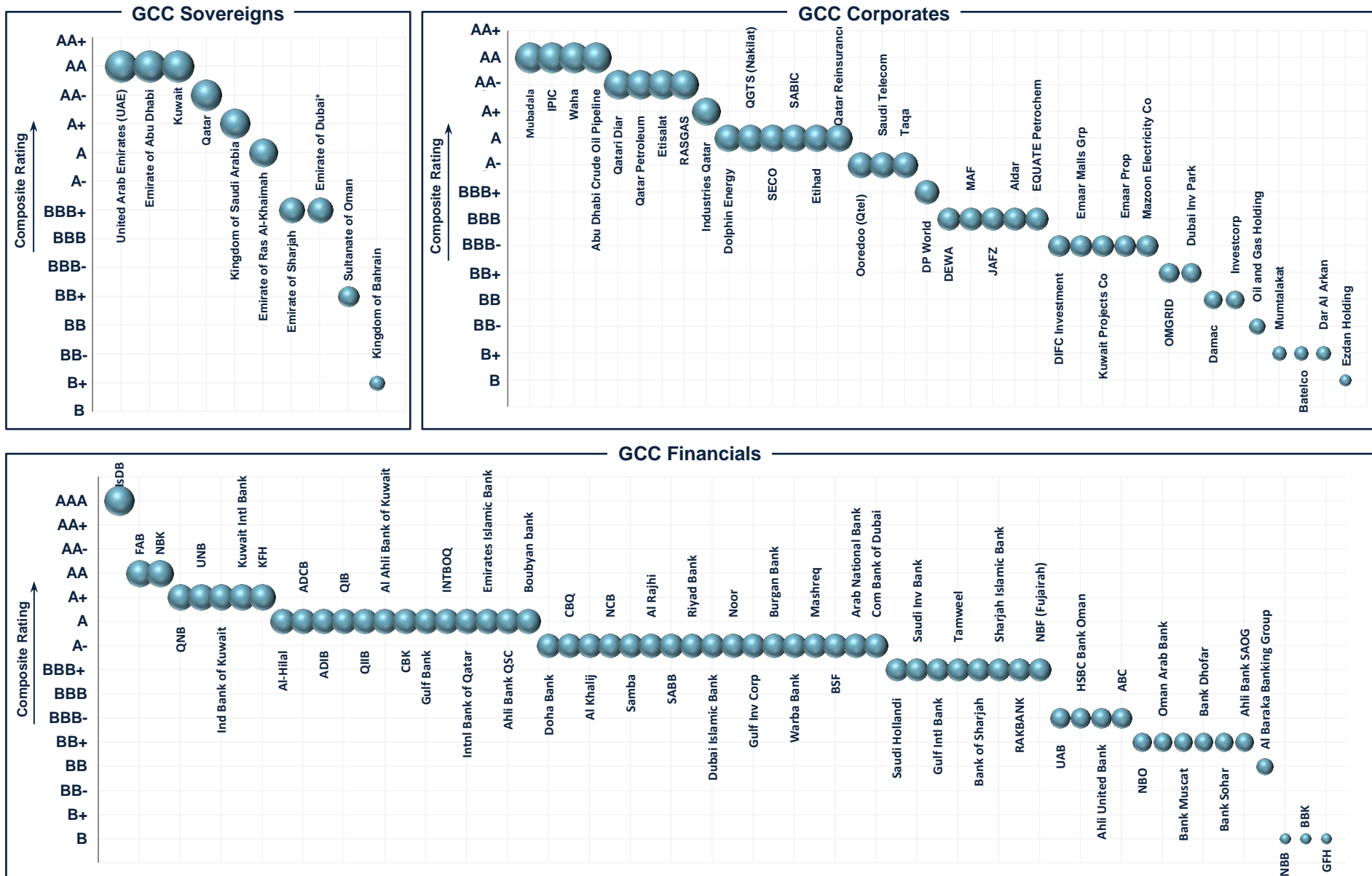
* Notes: Yields as on 15-October -2018; Composite rating - please refer Appendix for definition and calculation method; Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to Emirate of Sharjah (BBB+) and Dubai GREs like DP World (BBB+) and DEWA (BBB) Source: Bloomberg/FAB

GCC sub-inv. grade sovereign bonds vs EM peers – 30Y relative value



* Notes: Yields as on 15-October -2018; Composite rating - please refer Appendix for definition and calculation method; Source: Bloomberg/FAB

GCC credit quality at a glance

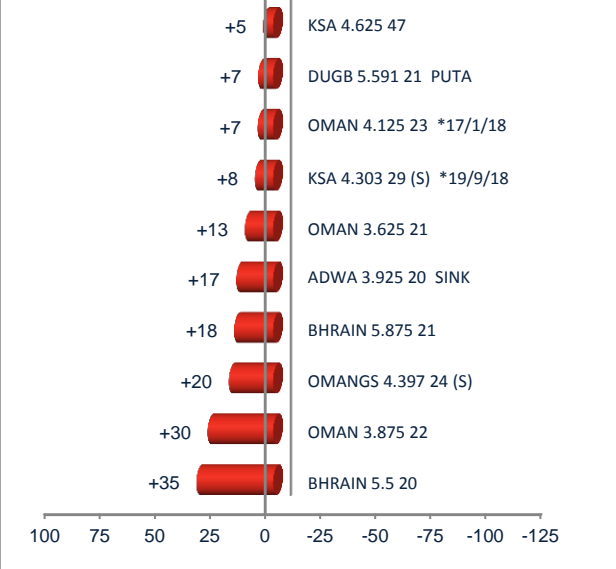
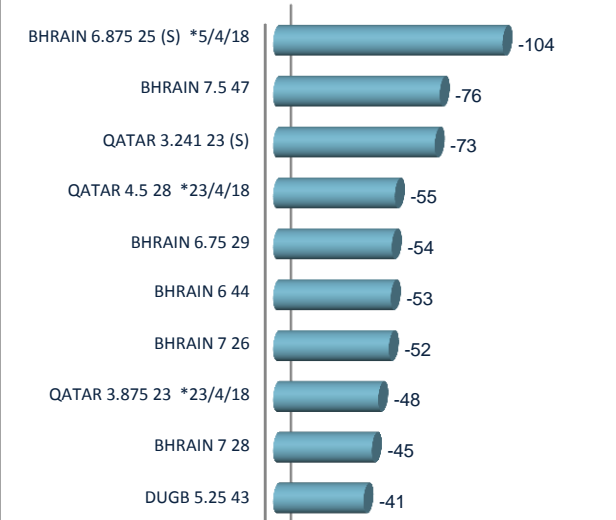


Note: The ratings mentioned here are composite credit rating for each issuer. Please see appendix for the methodology of calculating composite credit rating; * Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to DEWA (BBB+) and Emirate of Sharjah (BBB+) & ; Source: Bloomberg/FAB

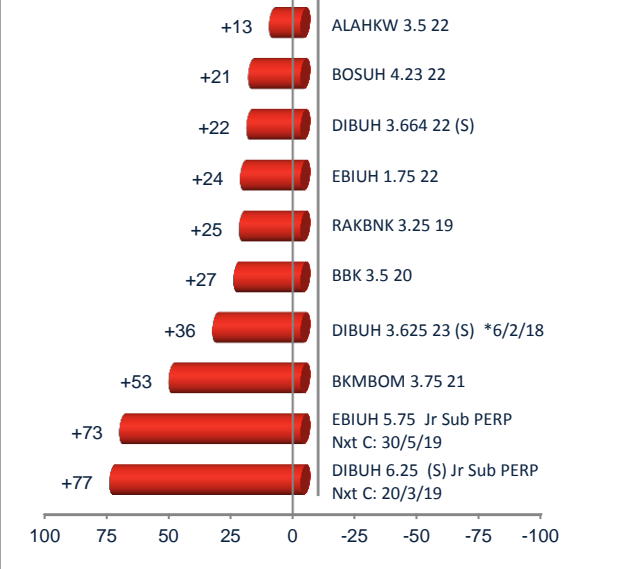
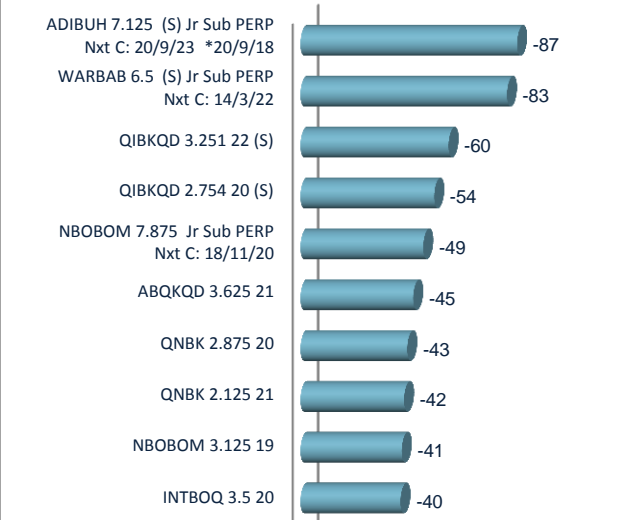
GCC spread performance summary

Top 10 / bottom 10 bond/sukuk performers (z-spread, bps) in each category from 29th Dec 2017 to 15th Oct 2018

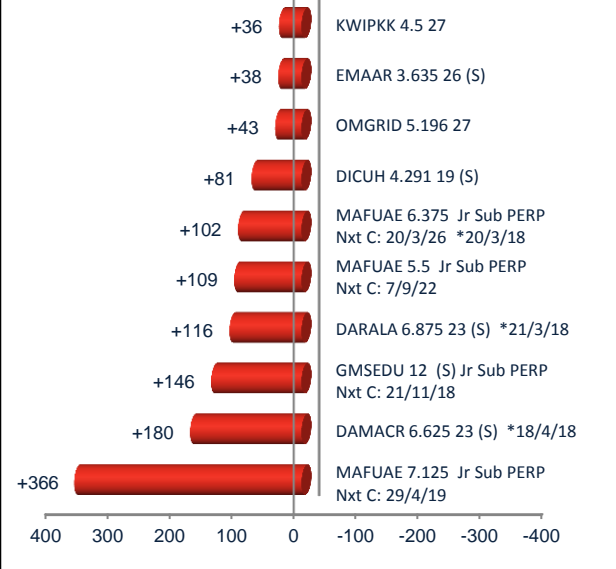
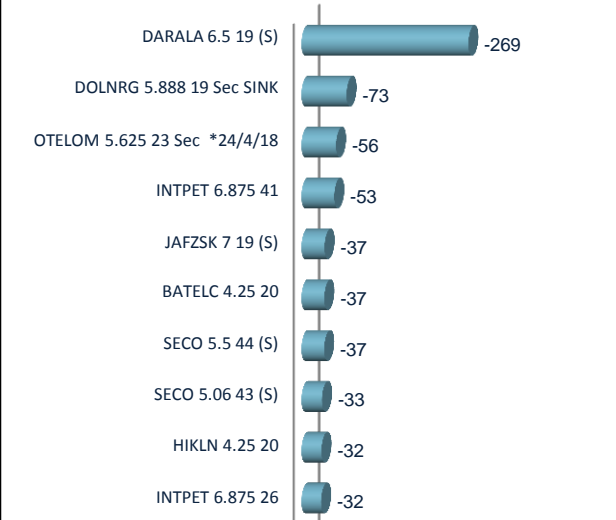
Sovereigns



Financials

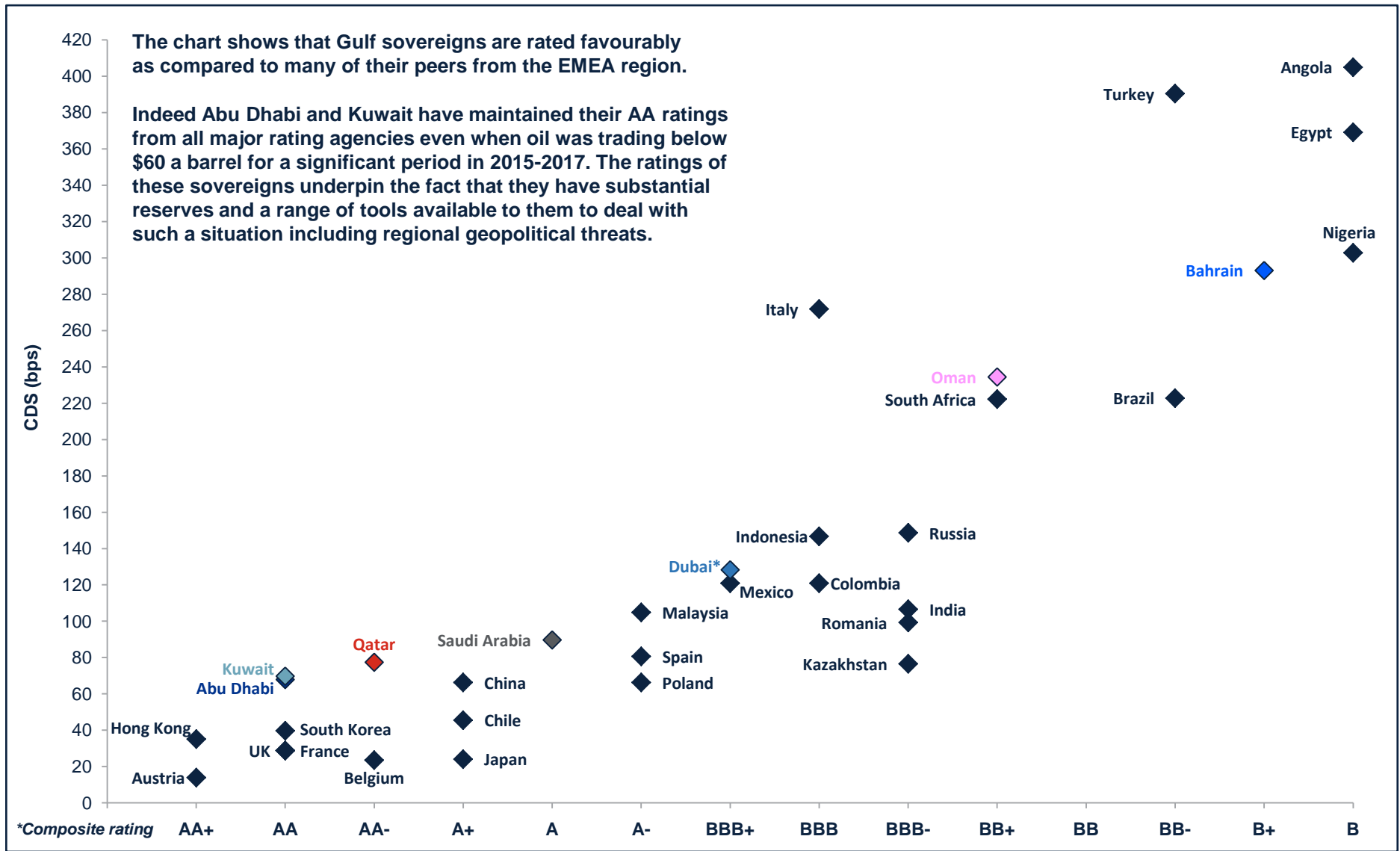


Corporates



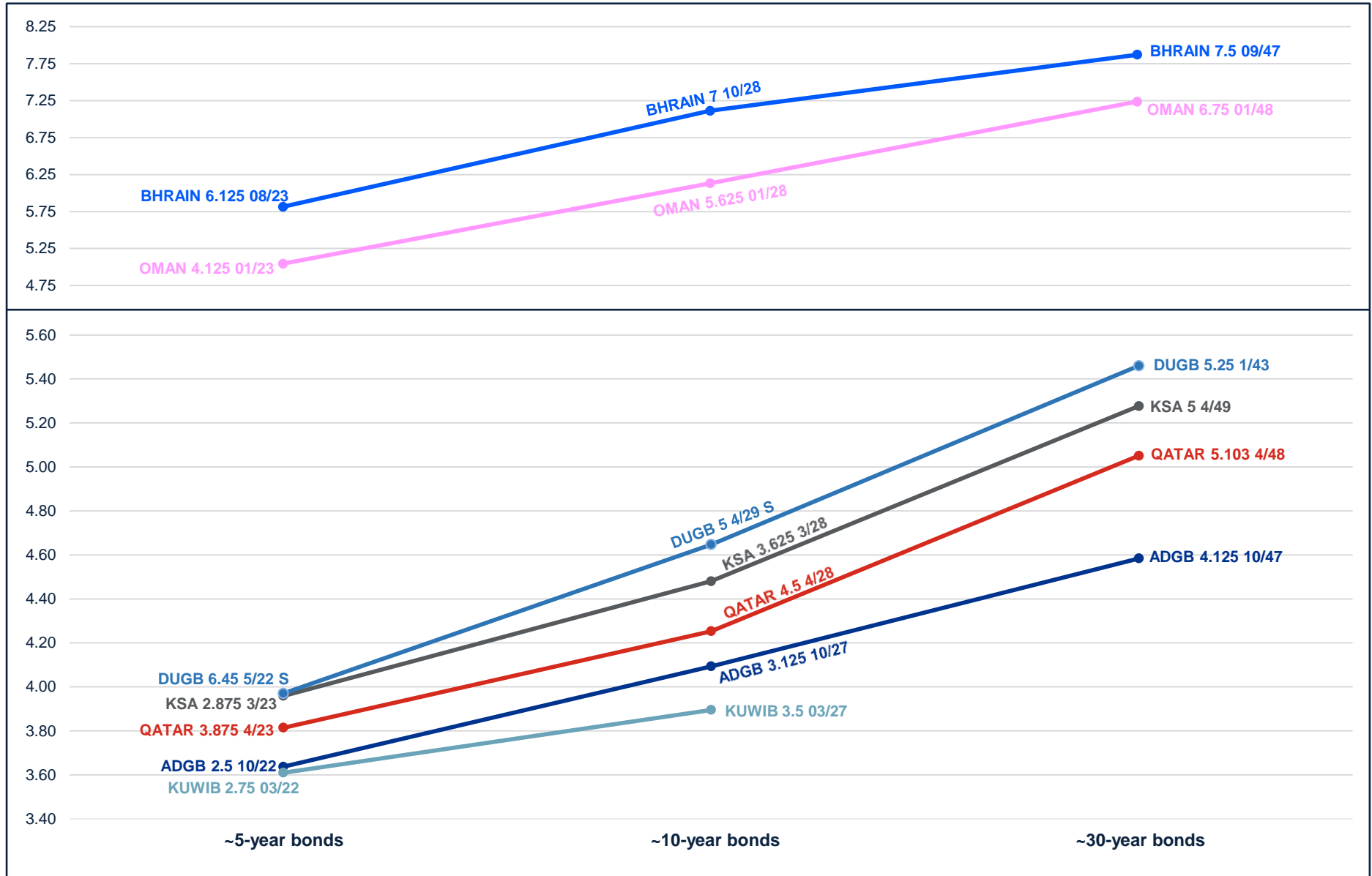
Notes: (1) We have used a list of GCC public debt which are maturing in 2019 or beyond; (2) (S) in the ticker indicates Sukuk; (3) All bonds/sukuks are \$ denominated unless any other currency is highlighted in the ticker. (4) All bonds/sukuks are senior unsecured debt unless an abbreviation for the debt type is highlighted in the ticker – e.g. – “Unsec” = Unsecured debt junior to Senior Unsecured debt; ; “Sub” = Subordinated; “Sr Sub” = Senior Subordinated; “Jr Sub” = Junior Subordinated; “Perp” = Perpetual; Callable, Puttable and Sinkable highlighted as “Call”, “Put”, & “Sink” respectively; (4) * highlights spread change from the 1st settlement date of the bond as it was issued in 2018; Source: FAB/Bloomberg

GCC sovereign credit ratings & CDS spreads versus peers



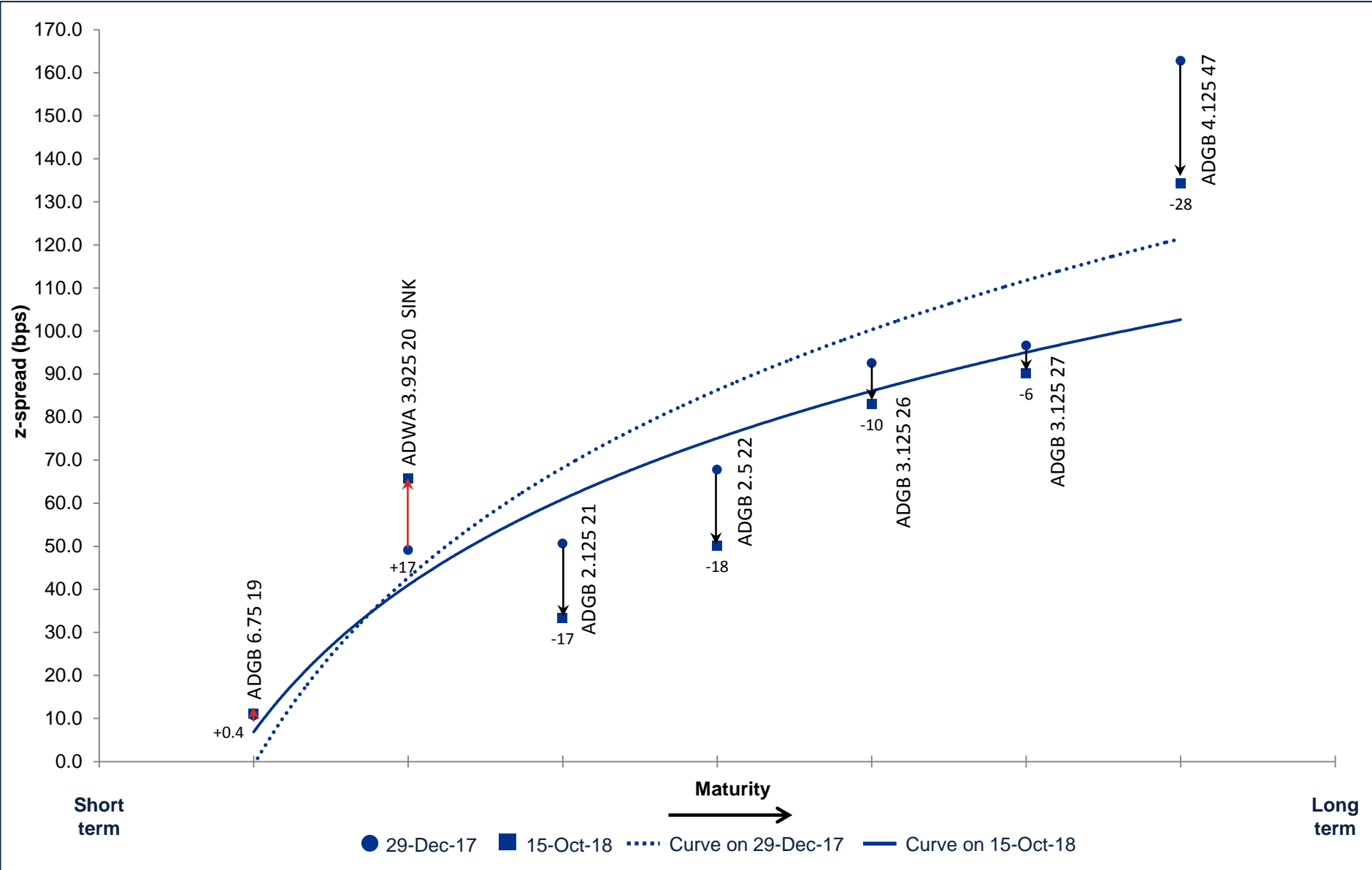
Notes: * X-axis represents the composite rating (please refer Appendix for calculation method); Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to Emirate of Sharjah (BBB+) and Dubai GREs like DP World (BBB+) and DEWA (BBB); The ratings have been arranged from higher to lower starting from 'AA', followed by 'AA-' and so on; CDS levels are for 15-October-18 & in basis points; Source: Bloomberg/FAB

GCC sovereign curves



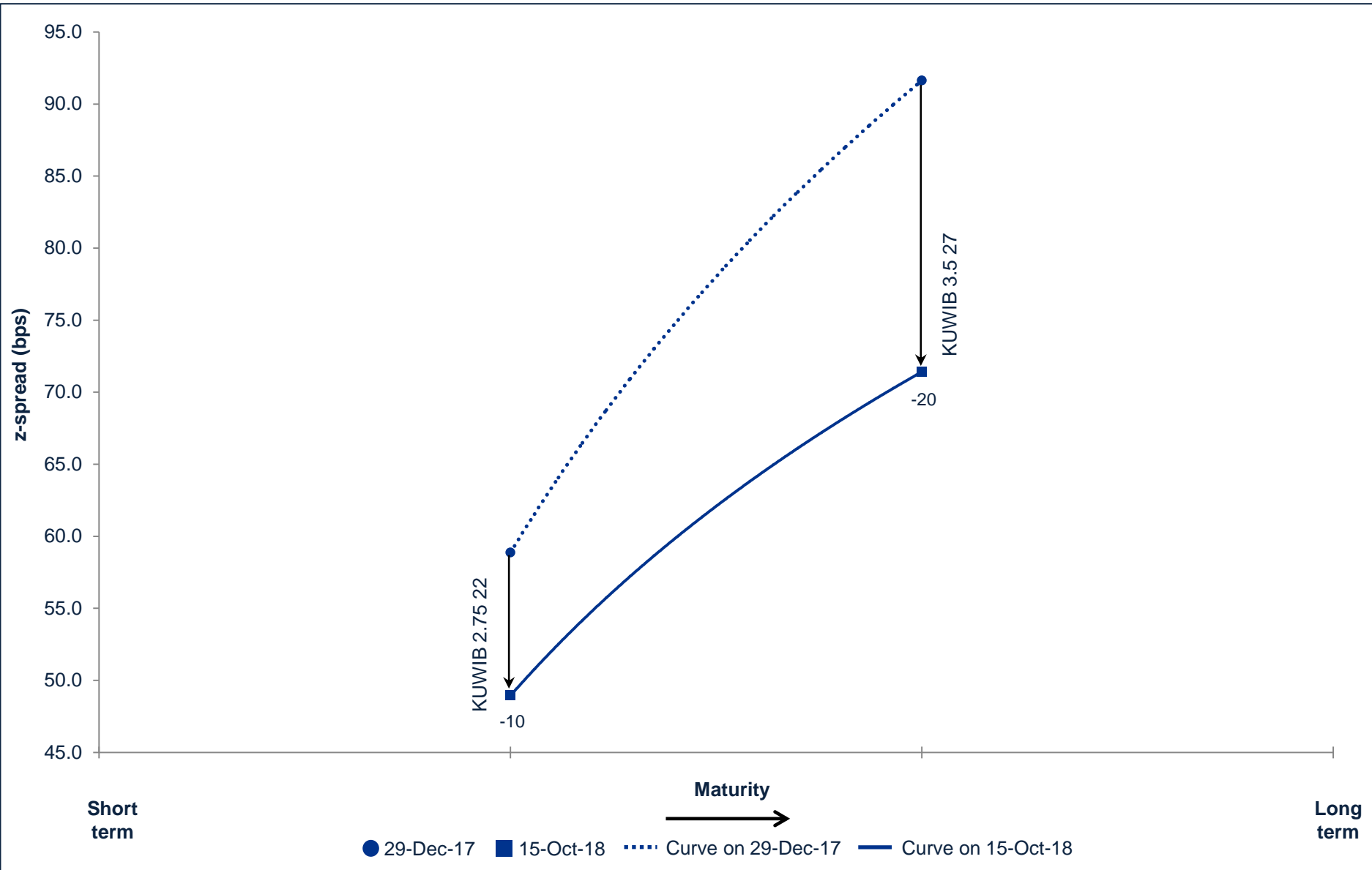
Notes: Curves as on 15-Oct-2018; "S" in the ticker indicates that the bond is Islamic (sukuk); Source: Bloomberg/FAB

Sovereigns spread performance – Abu Dhabi



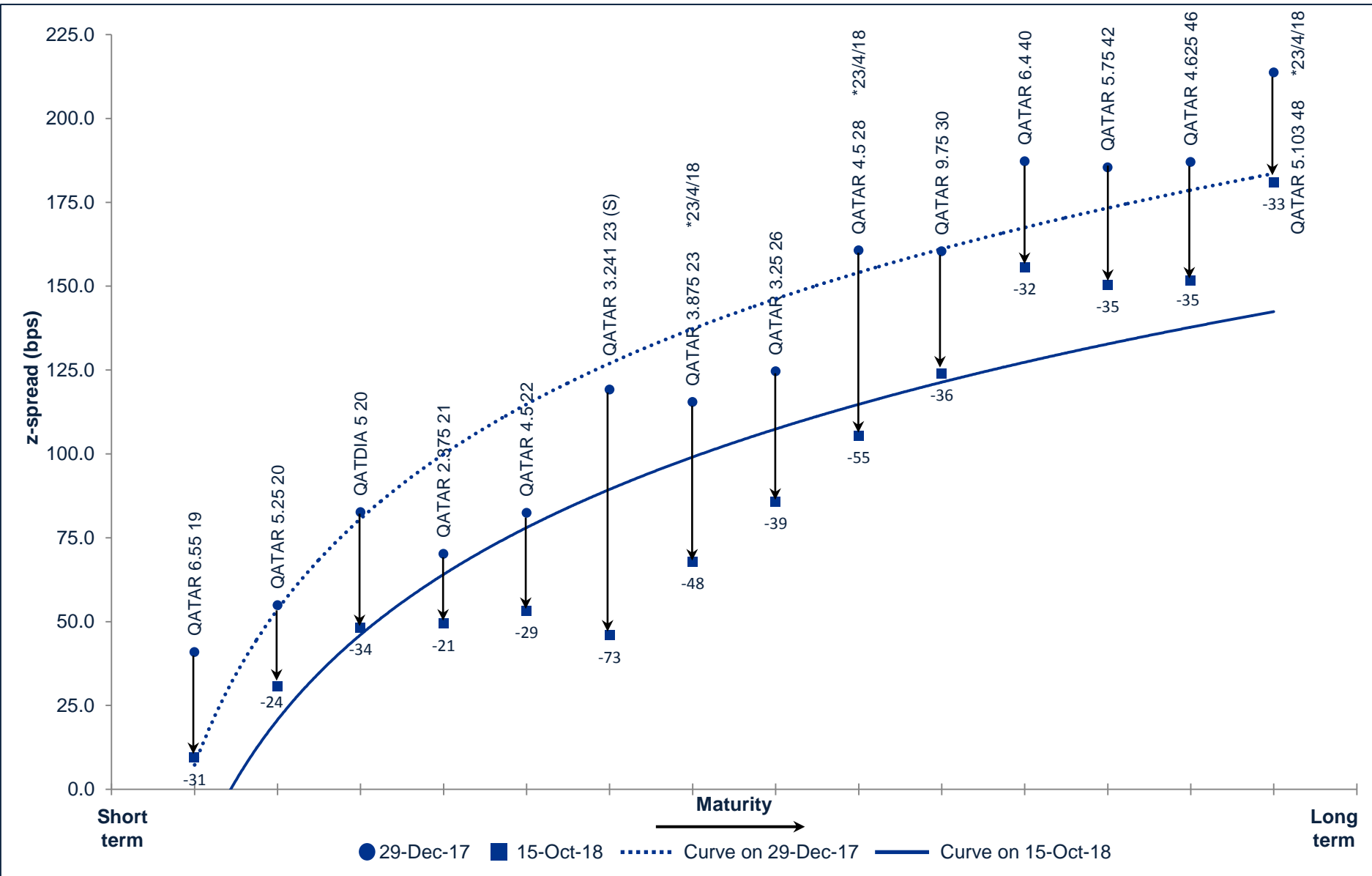
Source: FAB/Bloomberg

Sovereigns spread performance – Kuwait



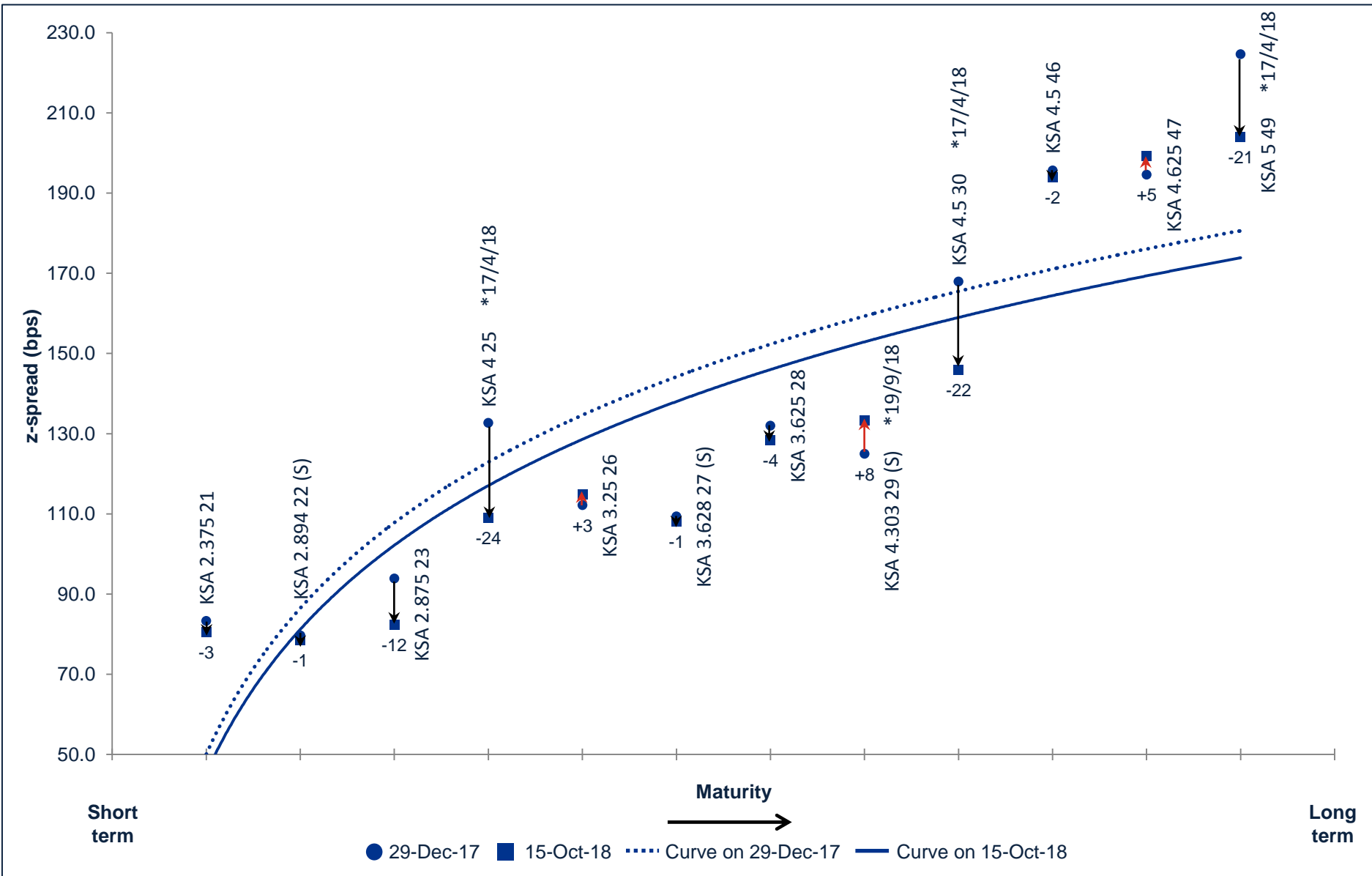
Source: FAB/Bloomberg

Sovereigns spread performance – Qatar



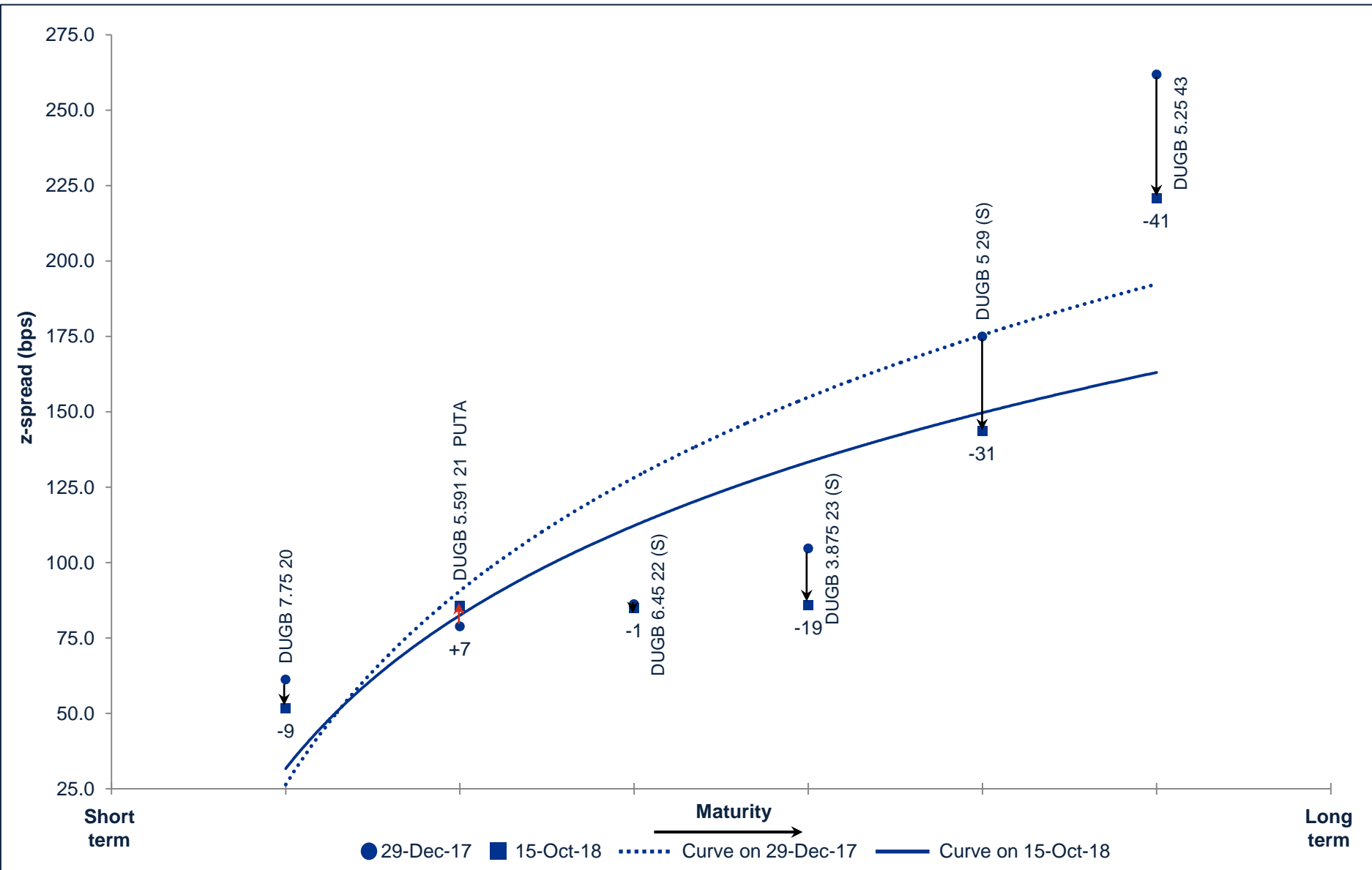
Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2018; If "Sukuk", the ticker contains "(S)" next to the maturity year; ** Included QATDIA in Qatar Sov curve as it is explicitly Govt guaranteed; Source: FAB/Bloomberg

Sovereigns spread performance – Saudi Arabia



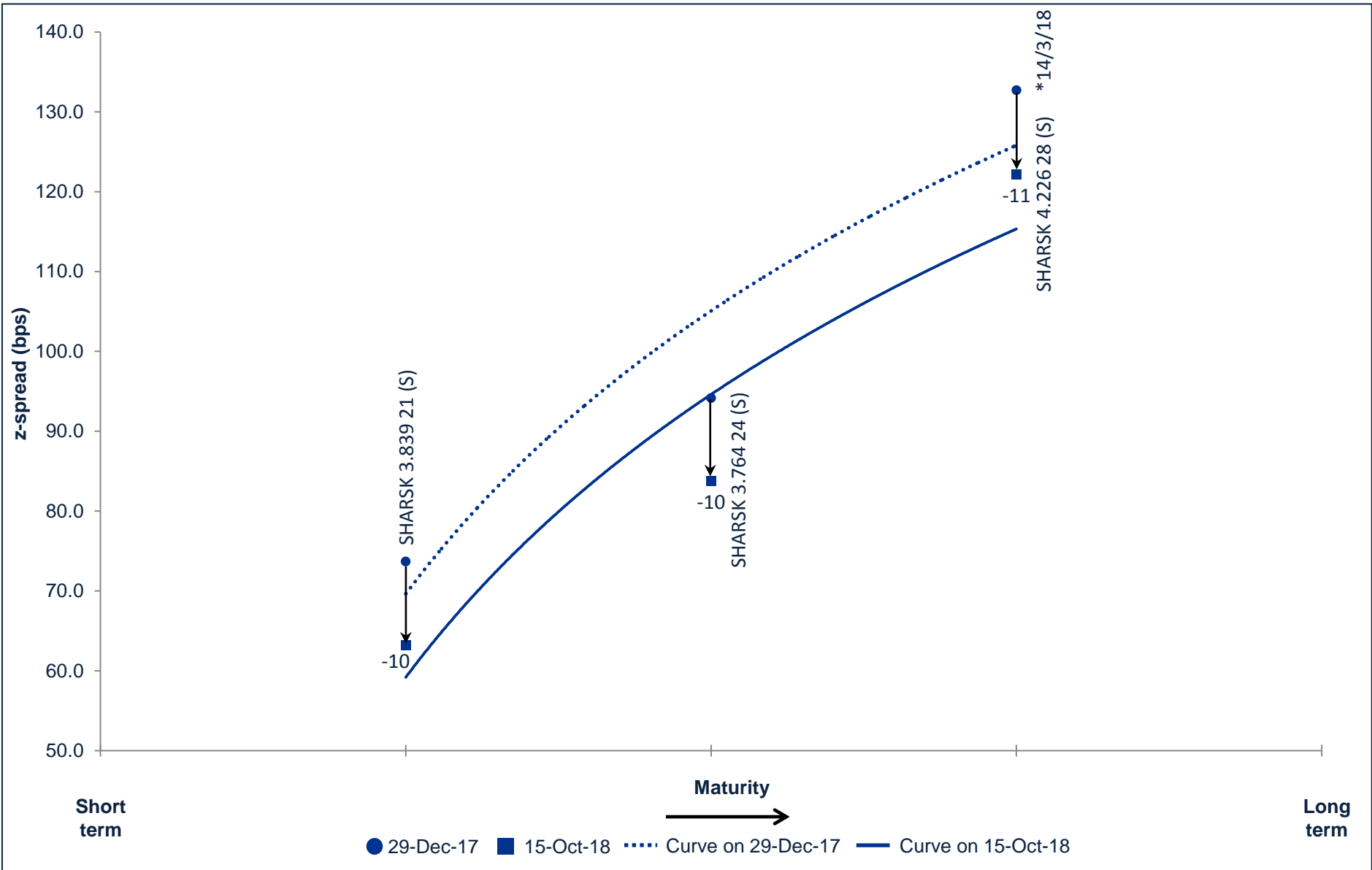
Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2018; If "Sukuk", the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Dubai



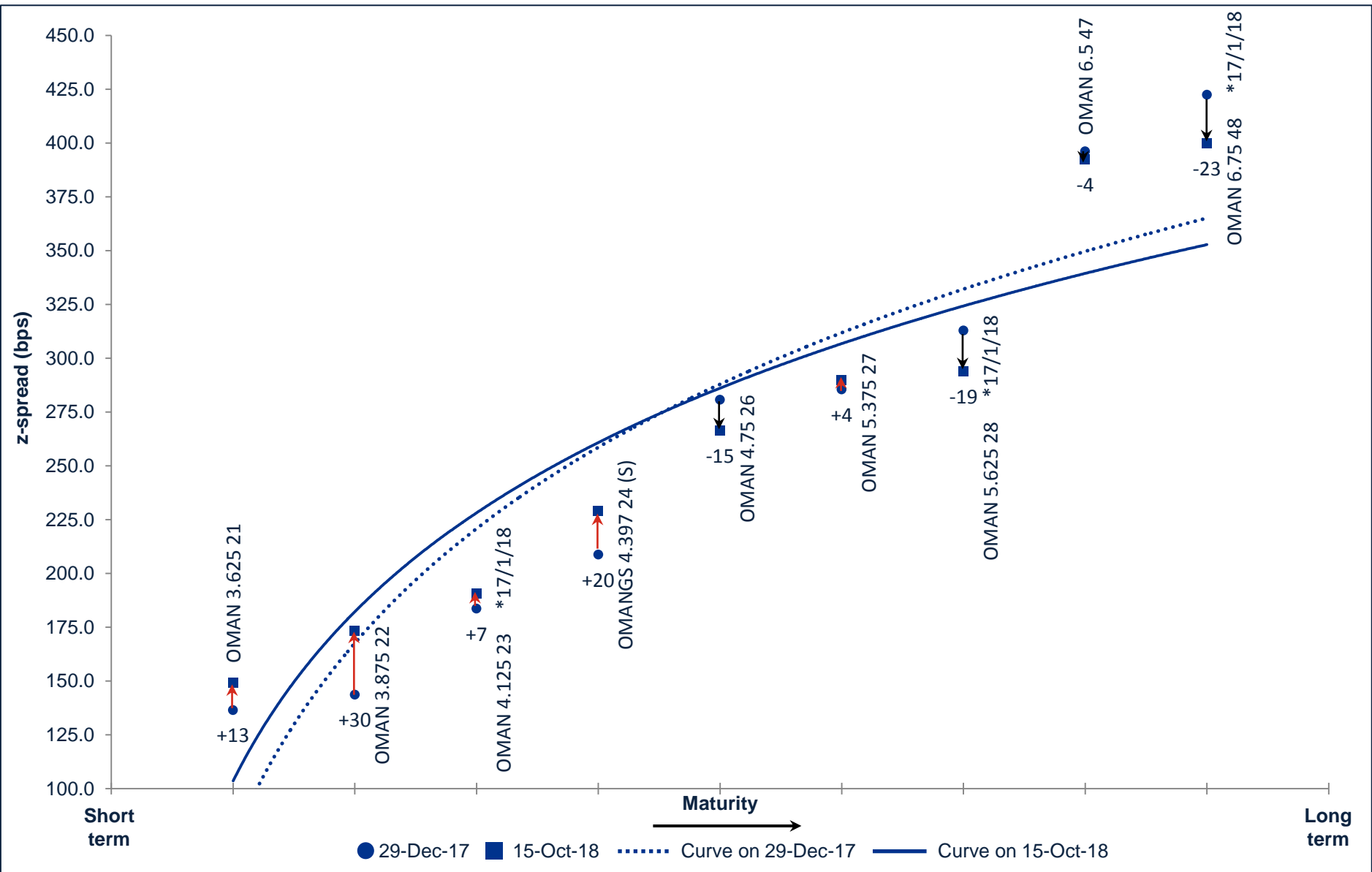
Notes: If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Sharjah



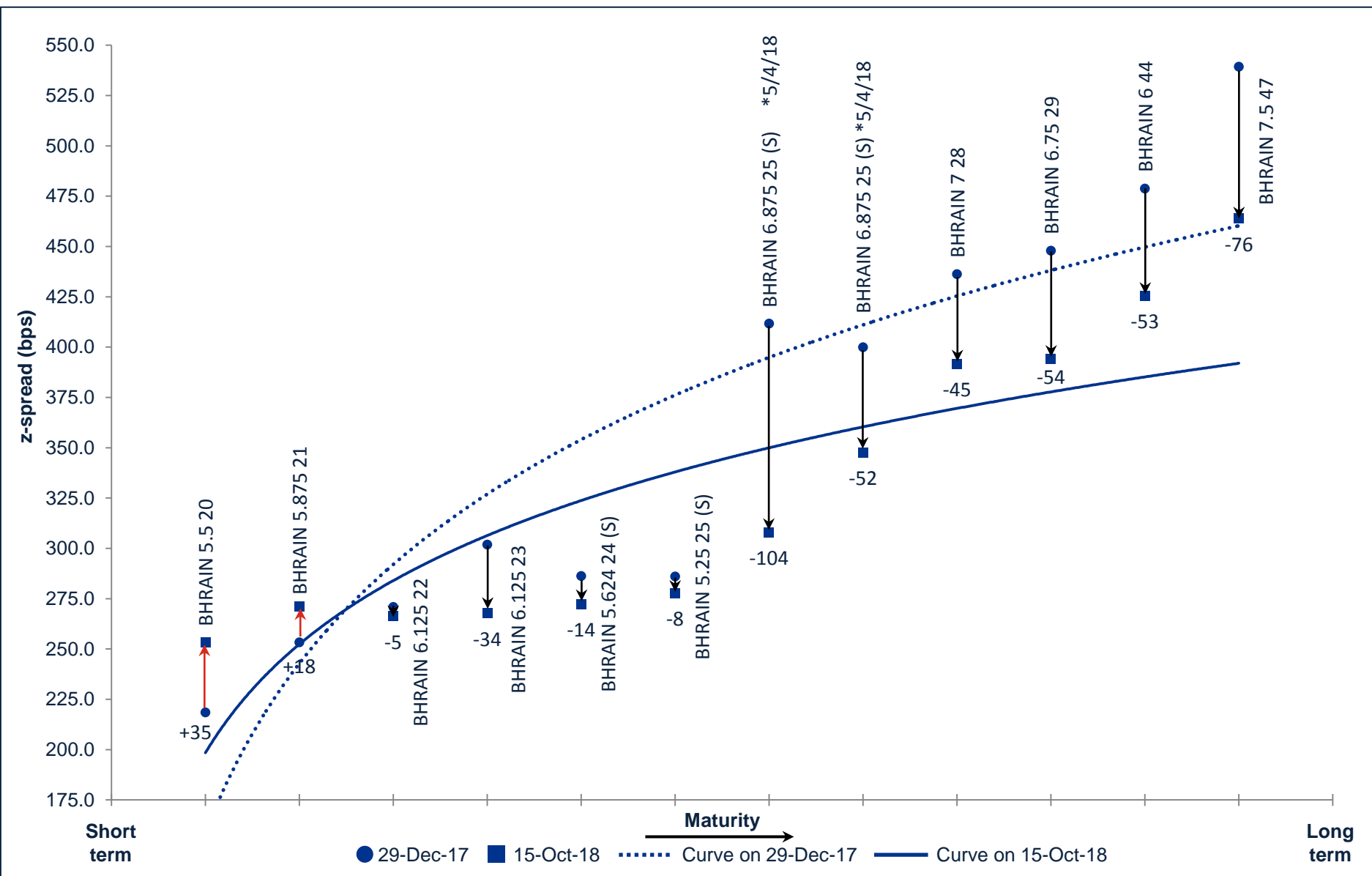
Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2018; If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Oman



Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2018; If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Bahrain



Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2018; If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Appendix

- As mentioned in above slides, we have used “composite ratings” for the credit quality analysis – i.e. the average of the ratings assigned by three leading rating agencies Moody’s, S&P and Fitch – in order to provide a more representative view of the credit strength of each bank.
- The composite rating is calculated as follows:
 - A score is assigned to the rating from each rating agency: AAA or equivalent being the best with a score of “1”, followed by AA+ or equivalent as “2”, AA or equivalent as “3”, AA- or equivalent as “4” and so on;
 - For example FAB is rated Aa3/AA-/AA- by Moody’s/S&P/Fitch. So the scores are 4/4/4;
 - Hence the average of the scores is “4” which indicates a composite rating of “AA-” for FAB;
 - In case the average score is not an absolute number – e.g. 4.33 (average of 4, 5, & 4) – the final score is derived by rounding off the average score to the nearest whole number. In this case “4”.



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