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FAB
First Abu Dhabi Bank

GCC Fixed Income Chart Book: FY 2017 Review

09 January 2018

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Foreword

Welcome to our FY 2017 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 2017 and the new issue trend over the past eight years
- Deal dynamics and relative value analysis
- Secondary Market performance of key instruments (snapshot from 30th December 2016 to 29th December 2017)

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 me.

Regards,

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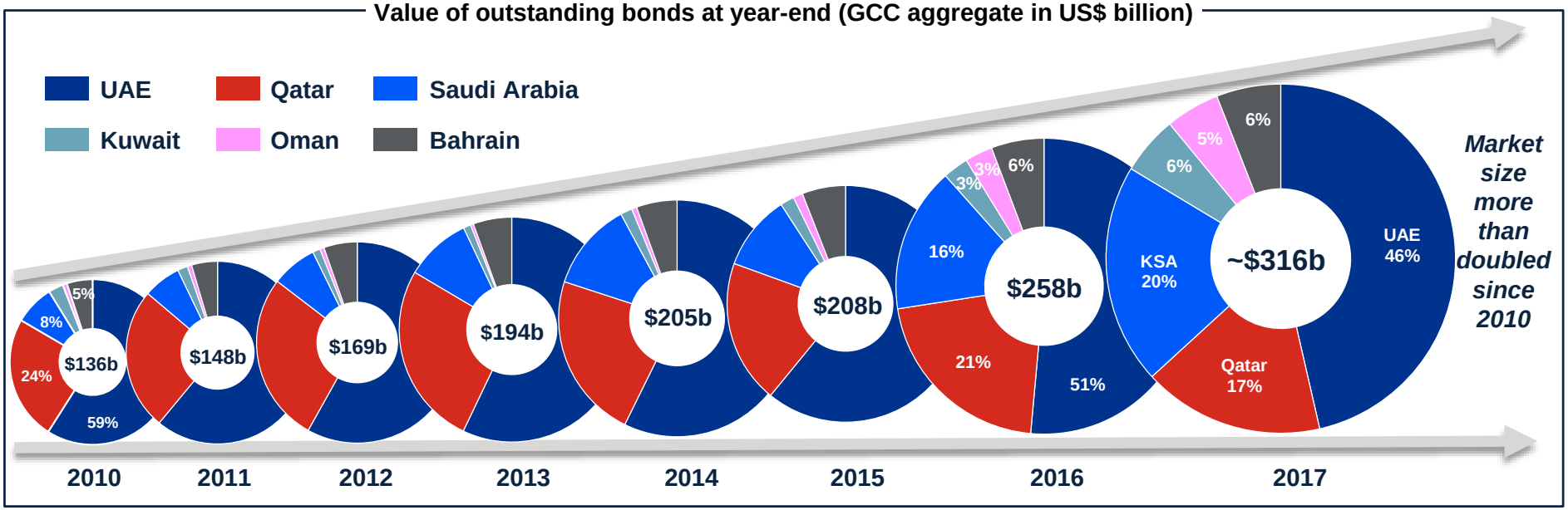
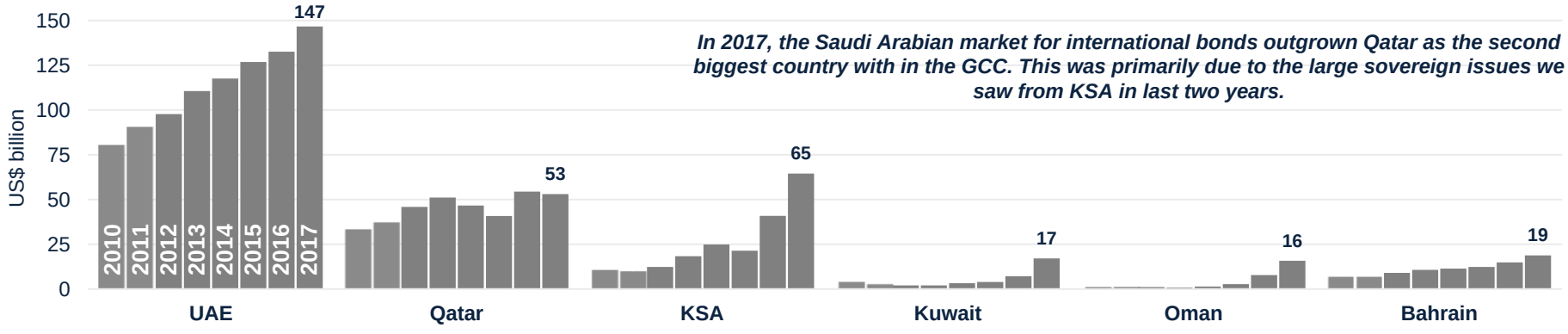
GCC international bonds & sukuk: How the market has evolved over the years?

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

Value of outstanding bonds at year-end (GCC aggregate in US$ billion)



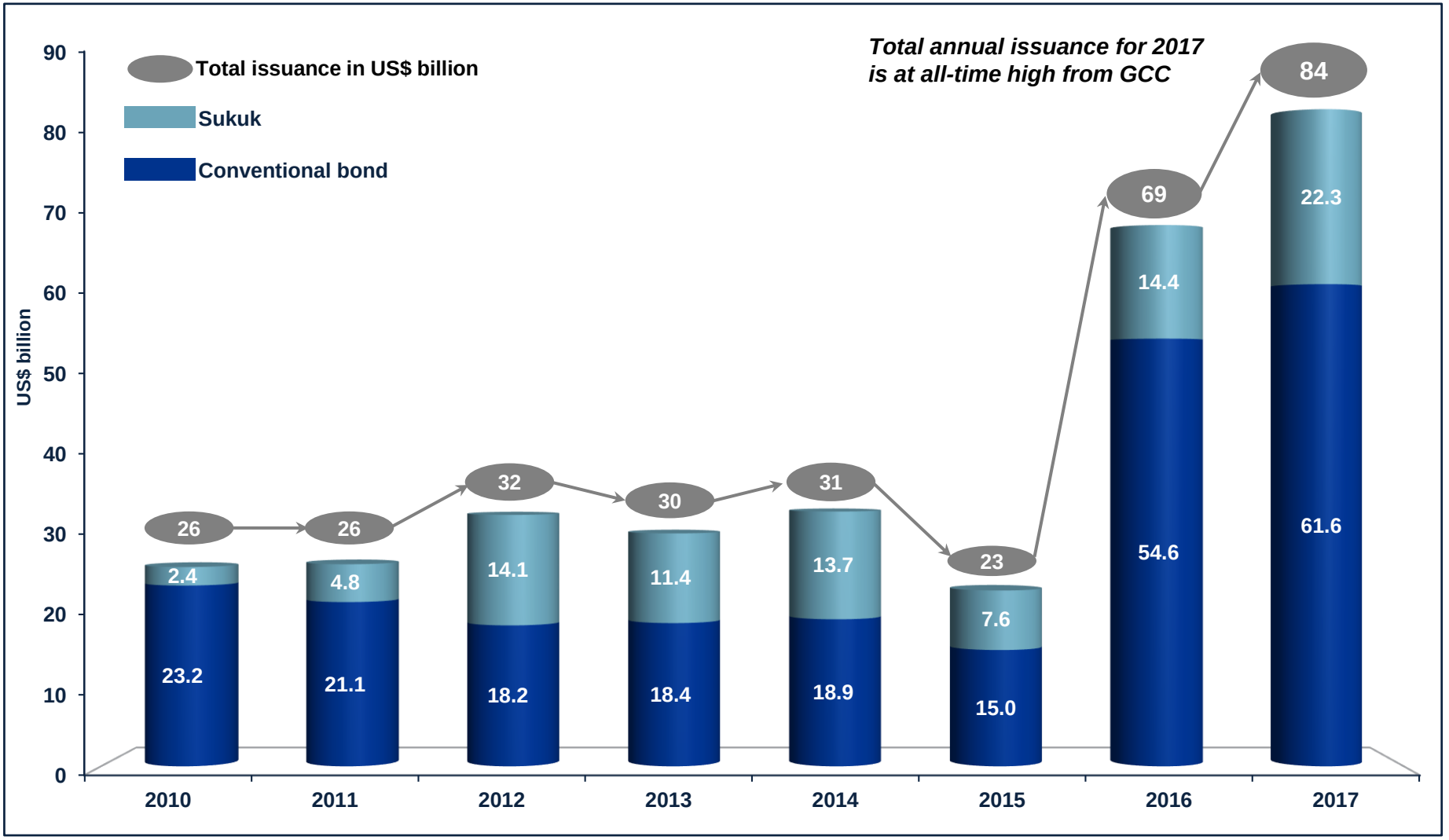
Value of outstanding bonds at year-end (country aggregate in US$ billion)



Source: Bloomberg/FAB

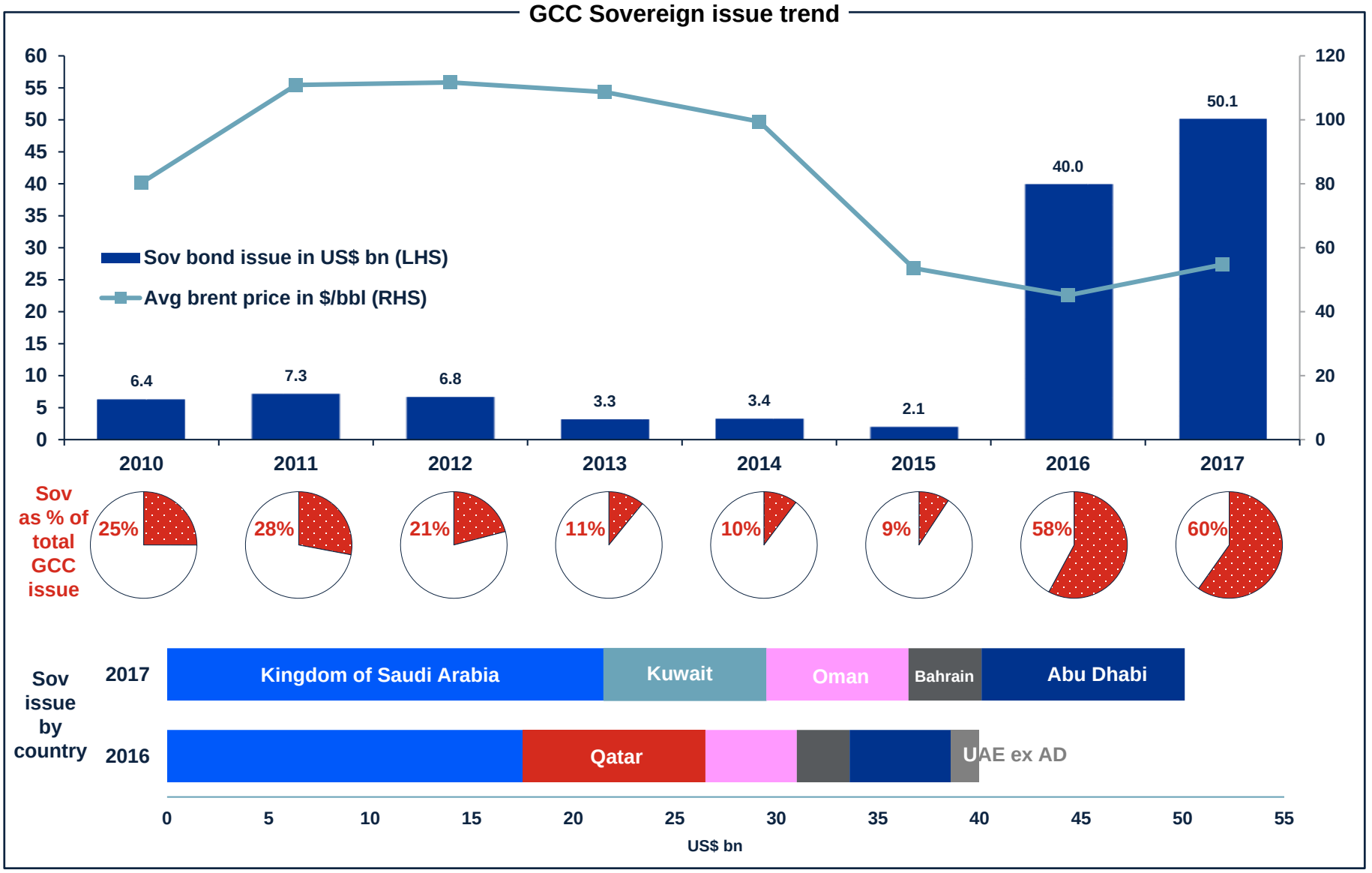
GCC bonds & sukuk issuance trend – 2017 was another record year…

For the below 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.



Source: Bloomberg/FAB

…and witnessed highest amount of sovereign issuances in this market

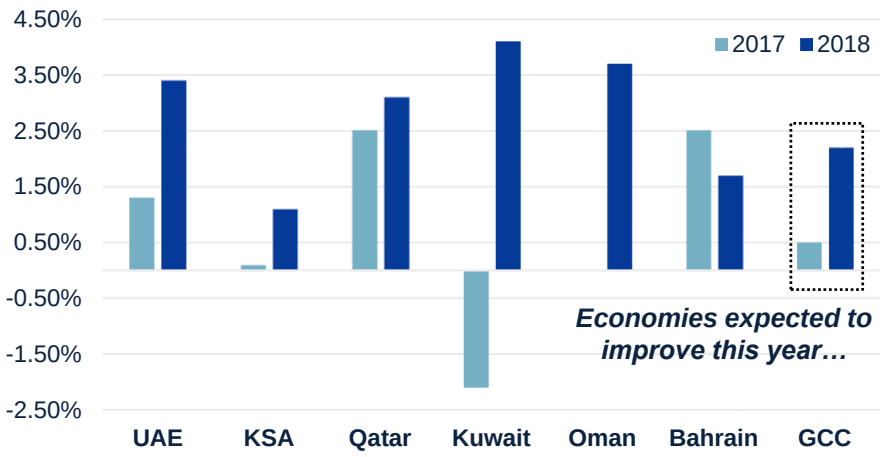


Source: Bloomberg/FAB

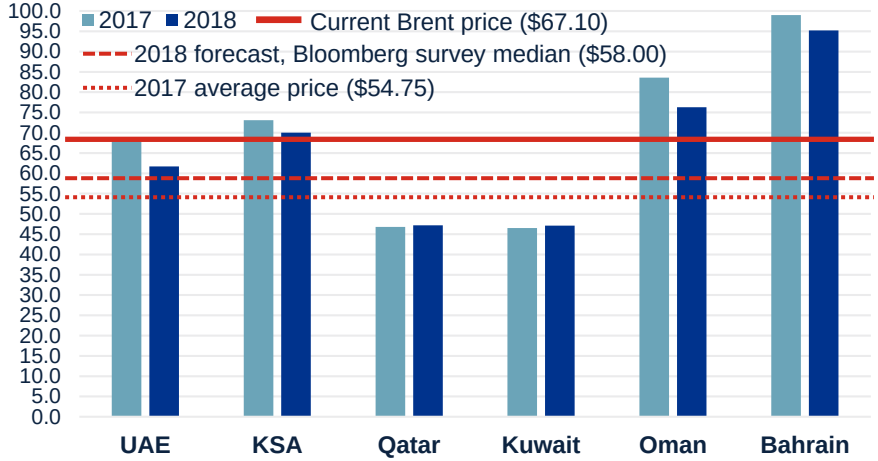
Sovereigns should continue to borrow in 2018, albeit at lower level

Economic growth across the GCC is expected to accelerate in 2018. Brent prices also stabilised near $60/bbl which should provide some fiscal buffer. However, fiscal deficits still persist, although improving. Governments thus need to continue their borrowing.

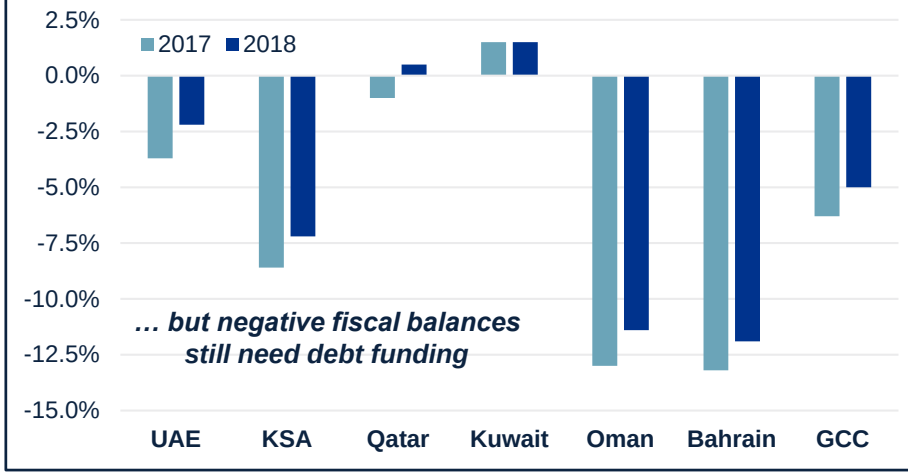
Real GDP growth (IMF estimates)



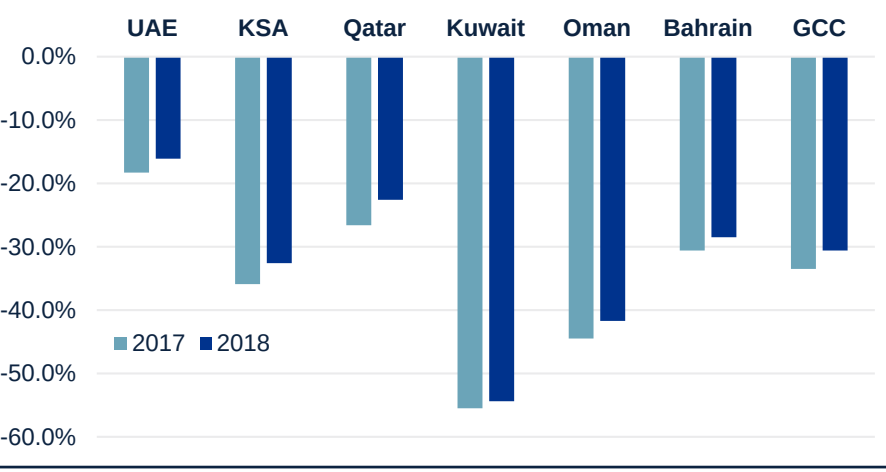
Break-even Brent oil price in US$/barrel (IMF estimates)



Govt. sector fiscal balance as % of GDP (IMF estimates)



Non-oil fiscal balance as % of GDP (IMF estimates)

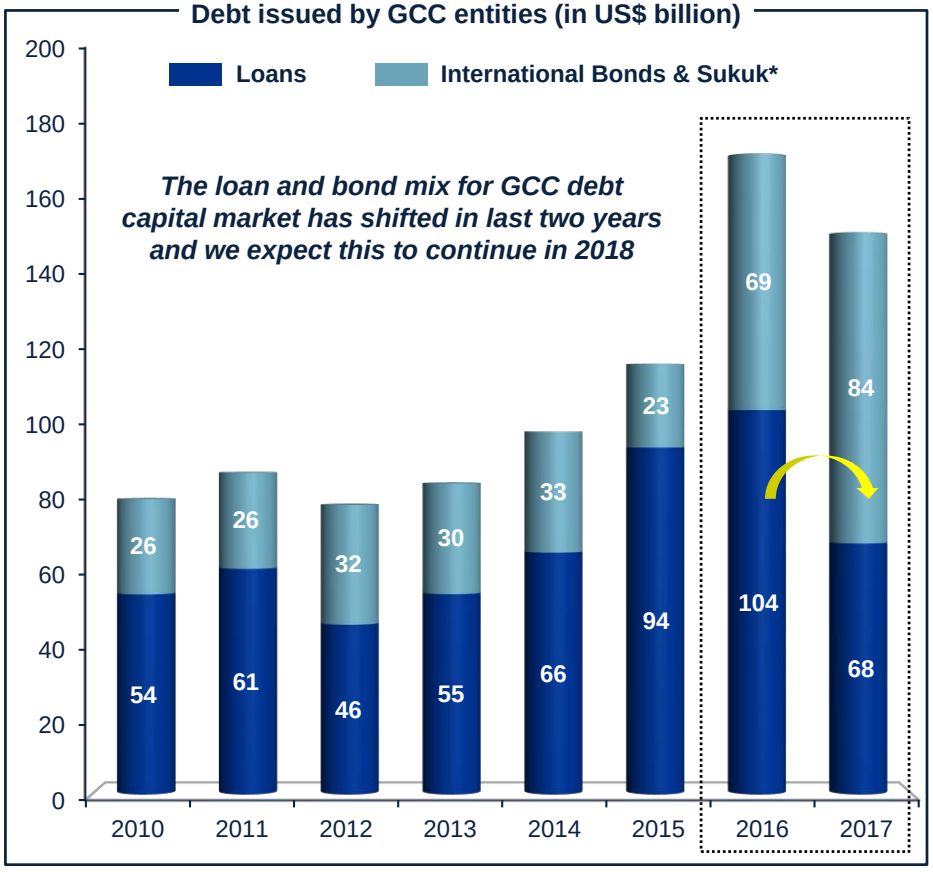


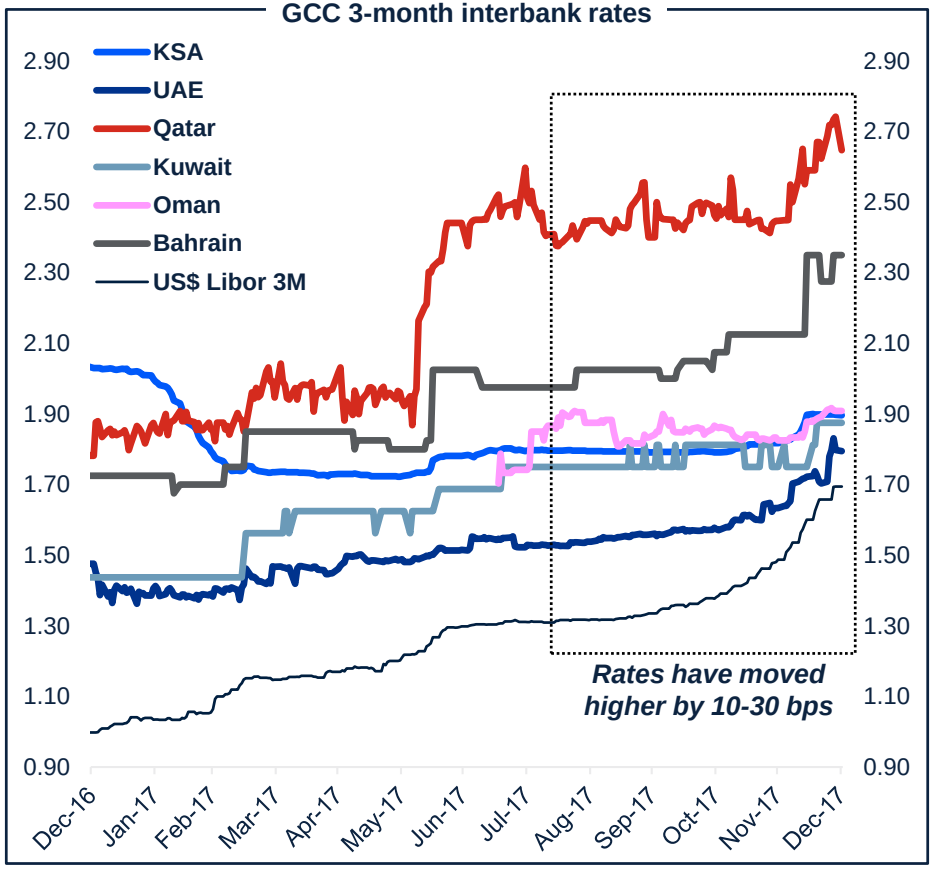
Source: IMF/Bloomberg/FAB

We expect corporate issuance to exceed sovereign issues in 2018

Corporate bond issuance could see an uptick this year and we back our rationale based on the following observations:

- ***Corporates & banks have a large refinancing need as some $60bn of loans and bonds maturing in 2018;***
- ***They could seek to lock in the relatively low level of interest rates still available in international market as local rates are rising;***
- ***They could capitalise on the demand from yield hungry international investors to diversify their sources of funding;***
- ***And more importantly, GCC governments have now established US$ yield curves to provide pricing benchmark for issuers.***





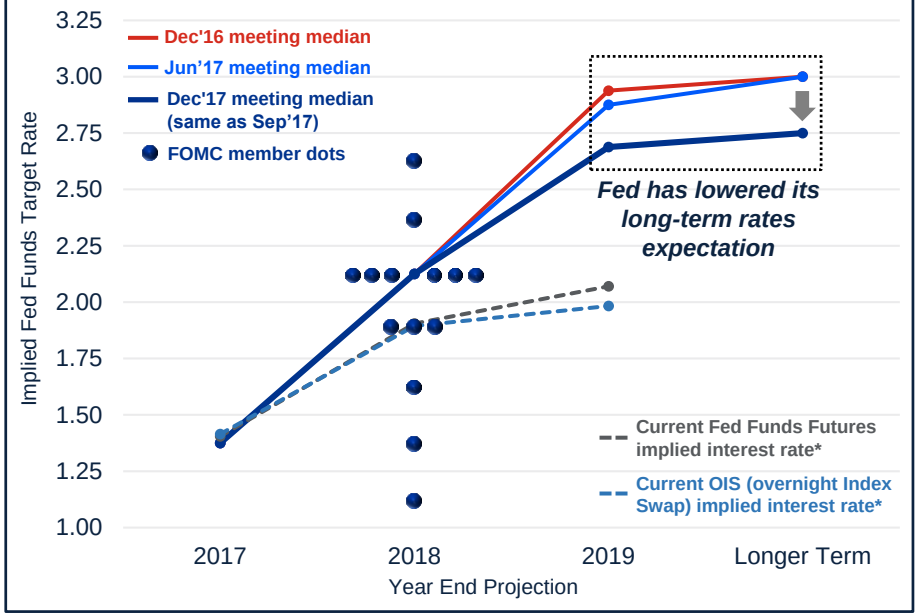
* **Notes**: International bonds & sukuk are the major hard currency ($/€/£/A$) deals from the GCC (fixed & floating; size >= $100m and tenor >= 1-year); Source: Bloomberg/FAB

Global rates environment still accommodative for GCC issuers

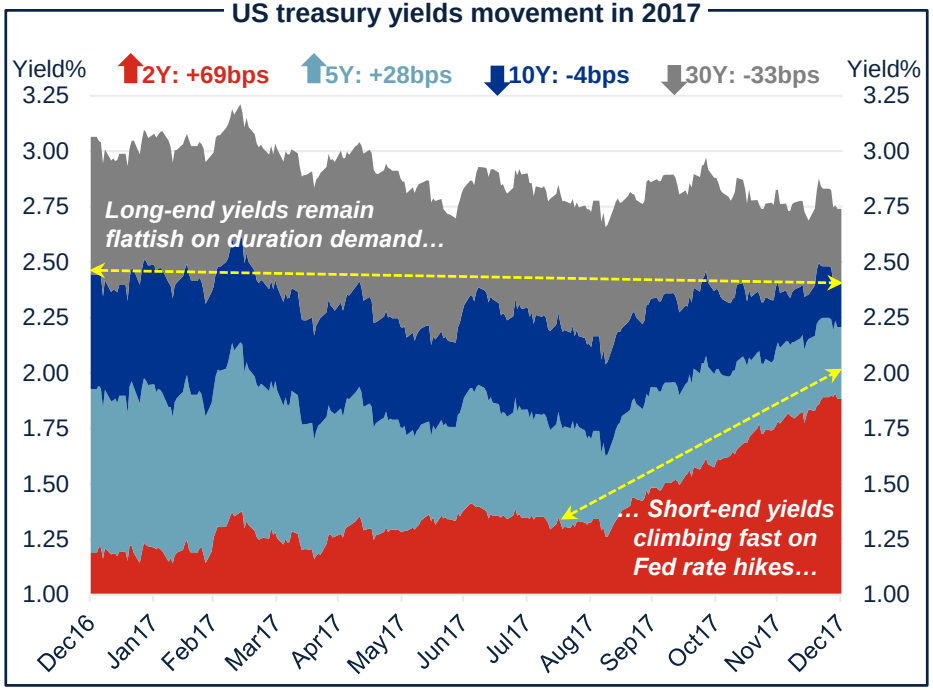
We expect 2018 debt issuance from the GCC to remain elevated, but lower than the record level we saw last year. We think issuers would opt for longer duration, bearing in mind the following factors:

- ***In Sep'17, the Fed lowered its expectation for long-term interest rate from 3.0% to 2.75% and it remains unchanged since. Furthermore, Fed still expects to raise rates at a gradual pace and sees only three hikes in 2018.***
- ***As a result, short-term rates have moved faster since Sep'17 pushing the 5y-10y & 5y-30y spread to record lows.***
- ***GCC issuers are increasingly diversifying their investor base and allocating more to investors from US & Europe, who usually bid for longer duration bonds for the yield.***

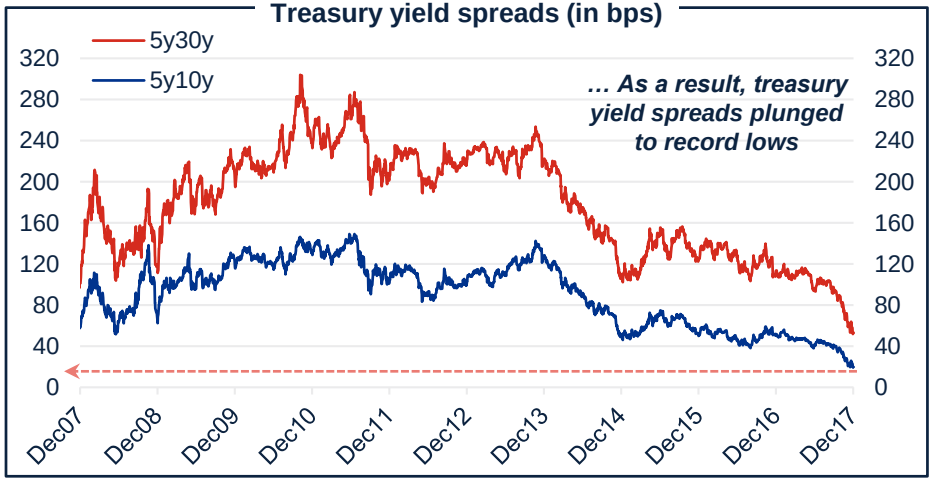
Fed's interest rate projection (FOMC Dots)



US treasury yields movement in 2017

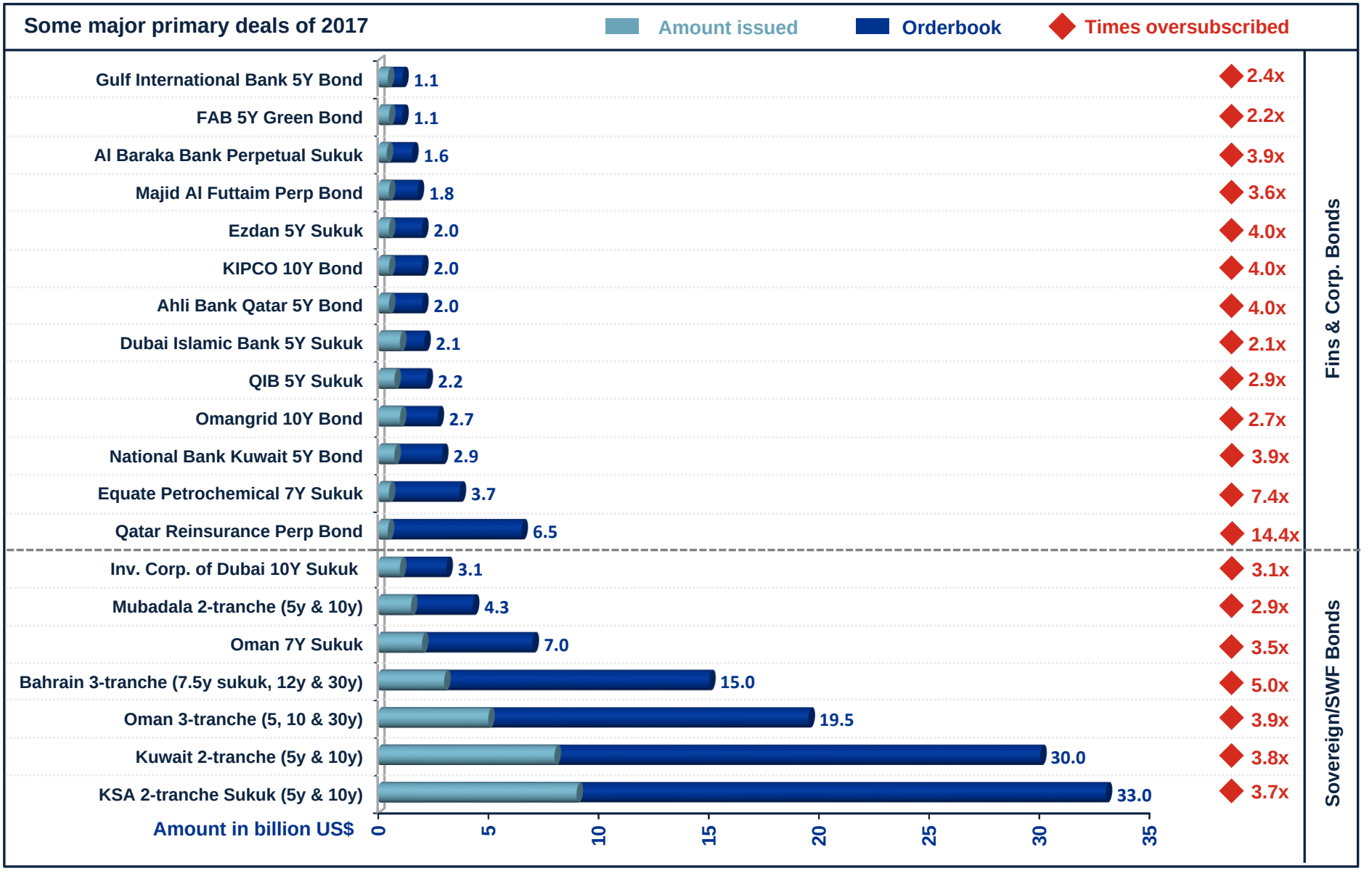


Treasury yield spreads (in bps)



Notes: * Rates are for 29-Dec-17; Source: Bloomberg/FAB;

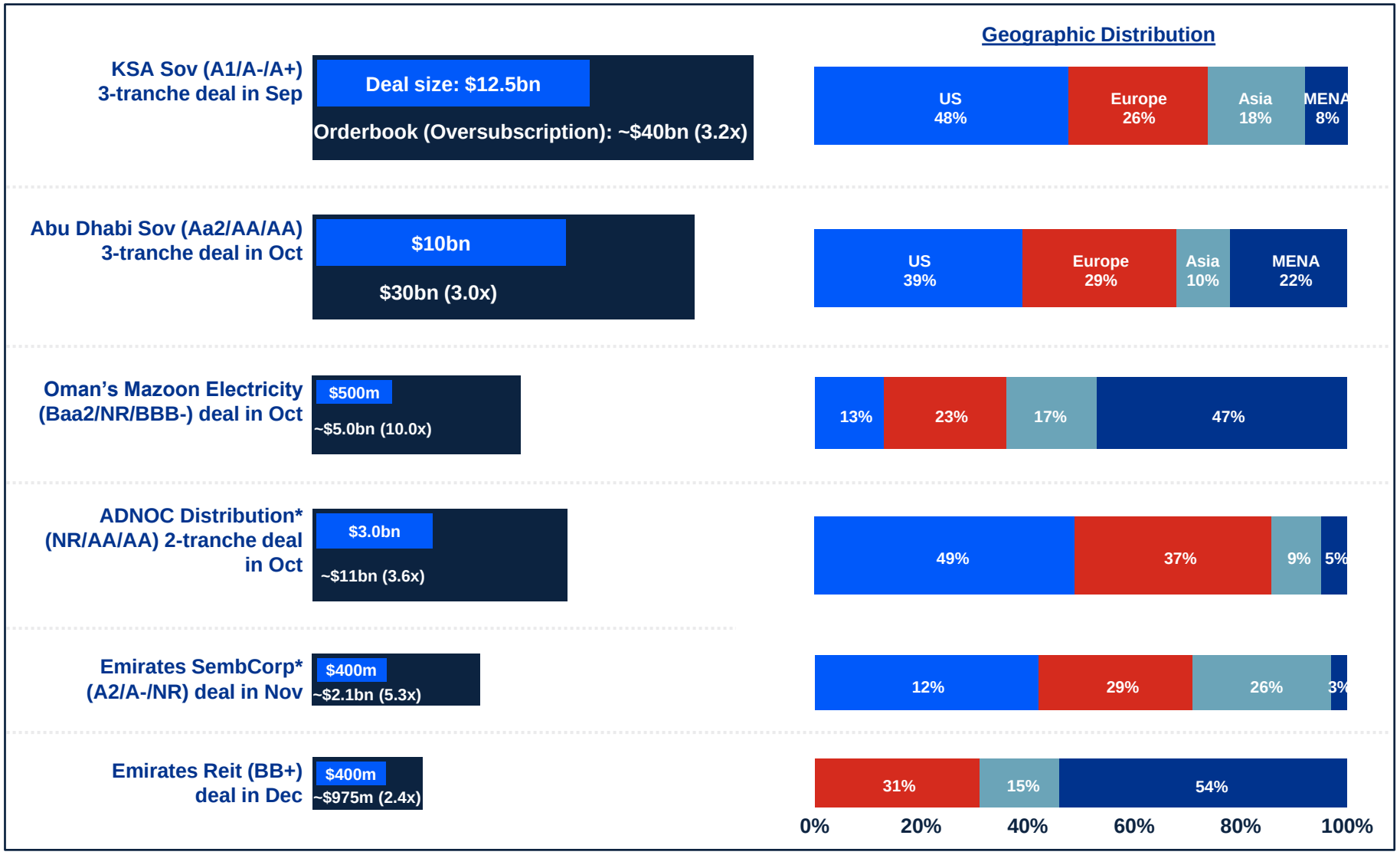
And demand remain robust for primary issues from the GCC



Source: Bloomberg/FAB

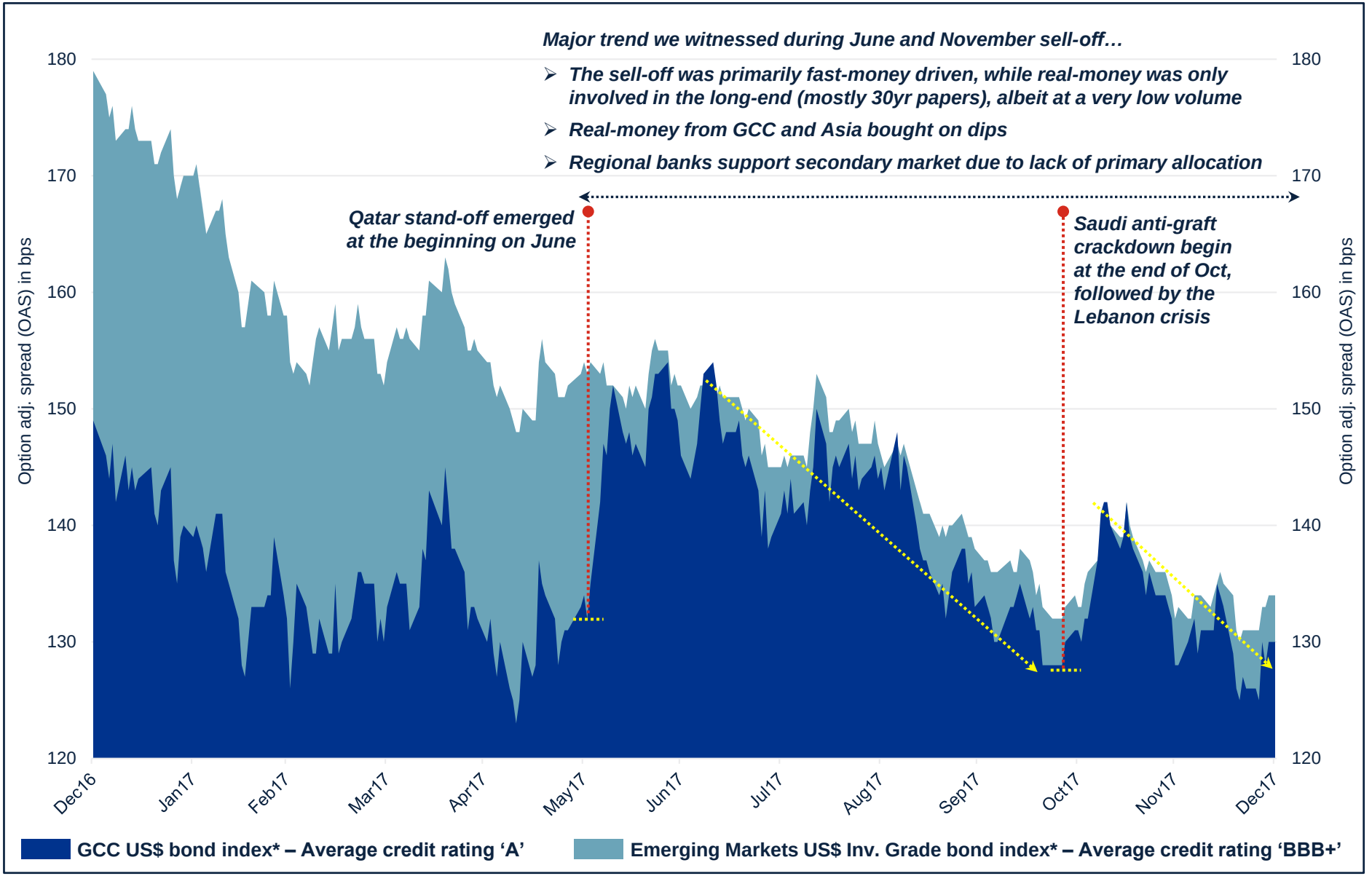
International appetite indeed appeared unscathed in recent deals…

…amid the startling political headlines that we witnessed from the region in the second half of 2017. Investor base for GCC deals are now well diversified with more than 50% of the demand coming from outside the MENA region. The below deals are indeed a testimony to this.



Note: Credit ratings are in following order Moody's/S&P/Fitch; NR is 'not rated'; *For ADNOC Distribution & Emirates SembCorp the ratings are bond ratings; Source: Bloomberg/FAB

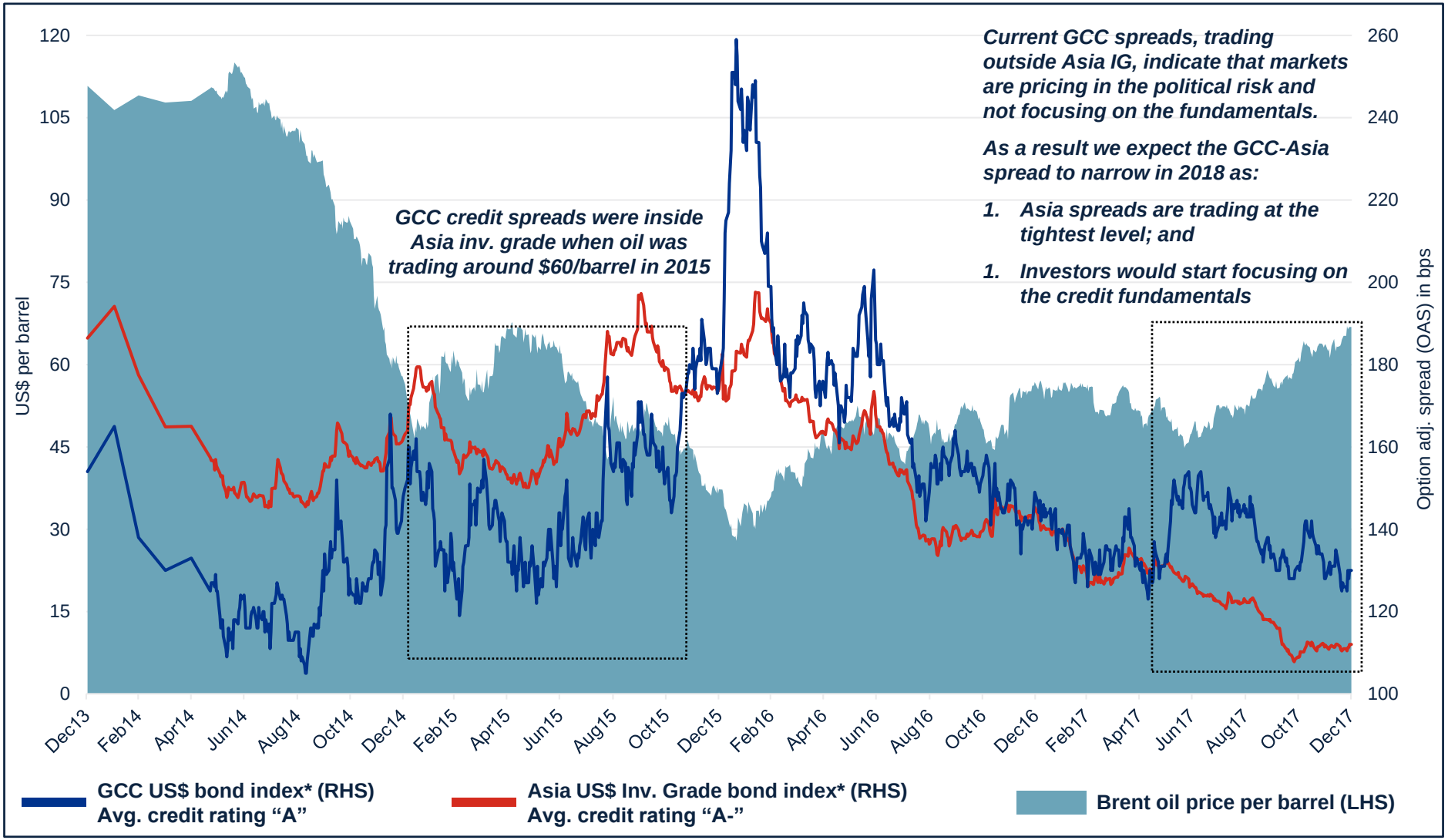
Regional geo-politics narrowed the GCC-EM spread in H2'2017



* **Notes:** Bloomberg/Barclays maintain the above indices on Bloomberg; BGCIOAS is the GCC US$ bond index & BEHGOAS is the EM IG US$ bond index; Source: Bloomberg/FAB

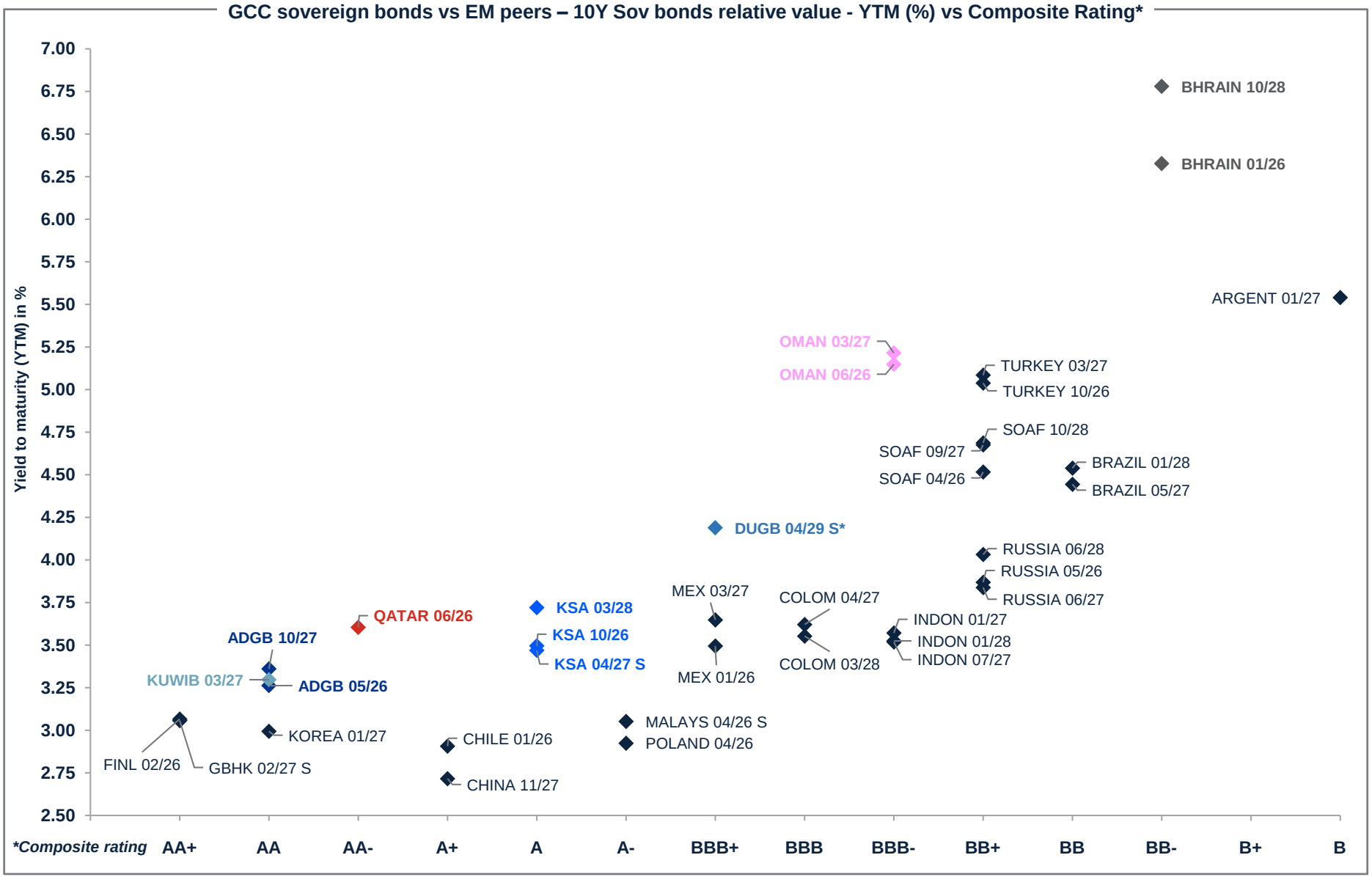
GCC credits offer pick up vs Asia investment grade credits…

… even though aggregate credit quality of GCC bonds – at 'A' – is one notch higher than the aggregate credit quality of Asian investment grade bonds.



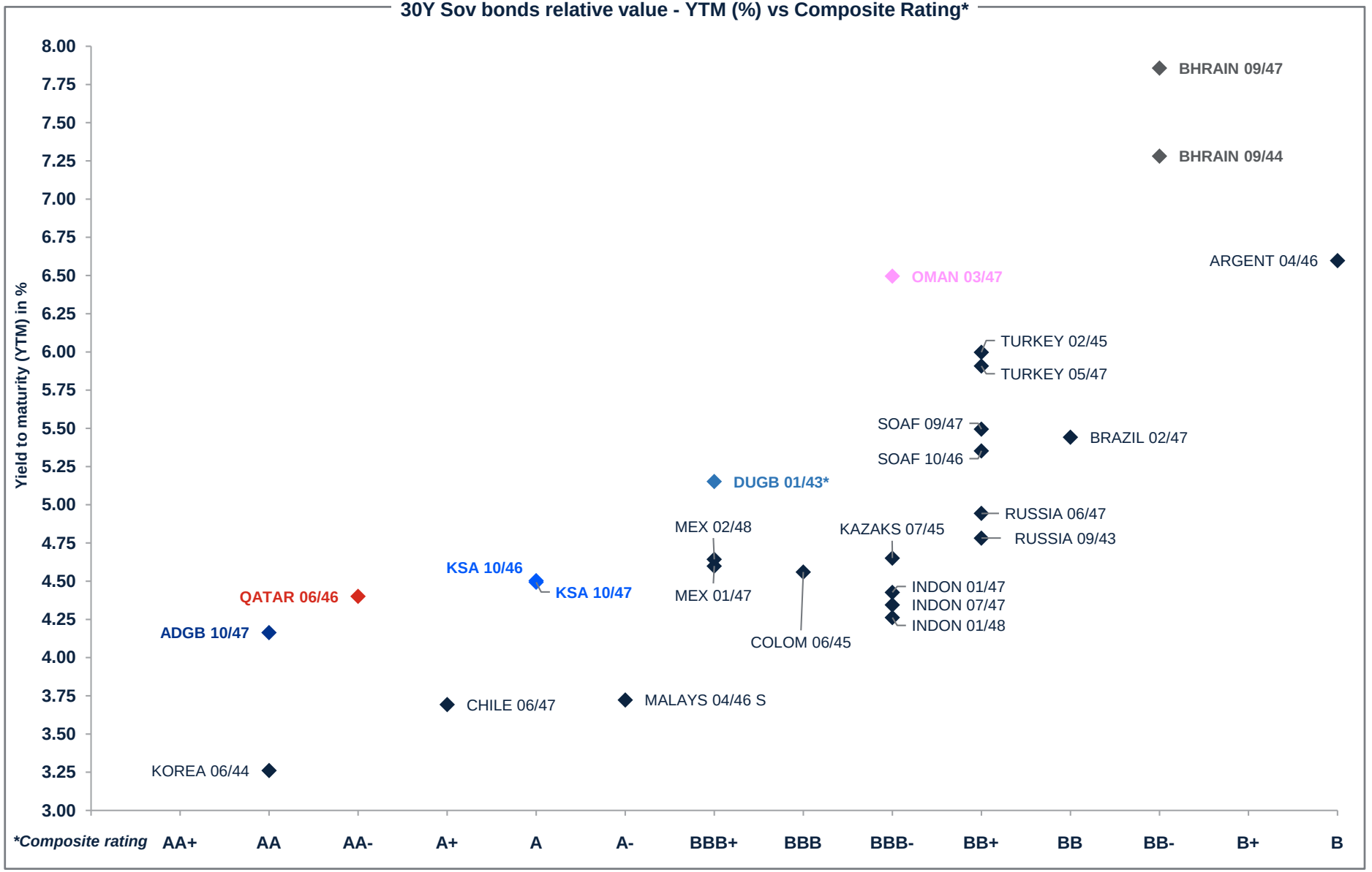
* **Notes:** Bloomberg/Barclays maintain the above indices on Bloomberg; BGCIOAS is the GCC index & BAIGOAS is the Asia IG index; Source: Bloomberg/FAB

The risk-reward is indeed more attractive for high quality GCC credits



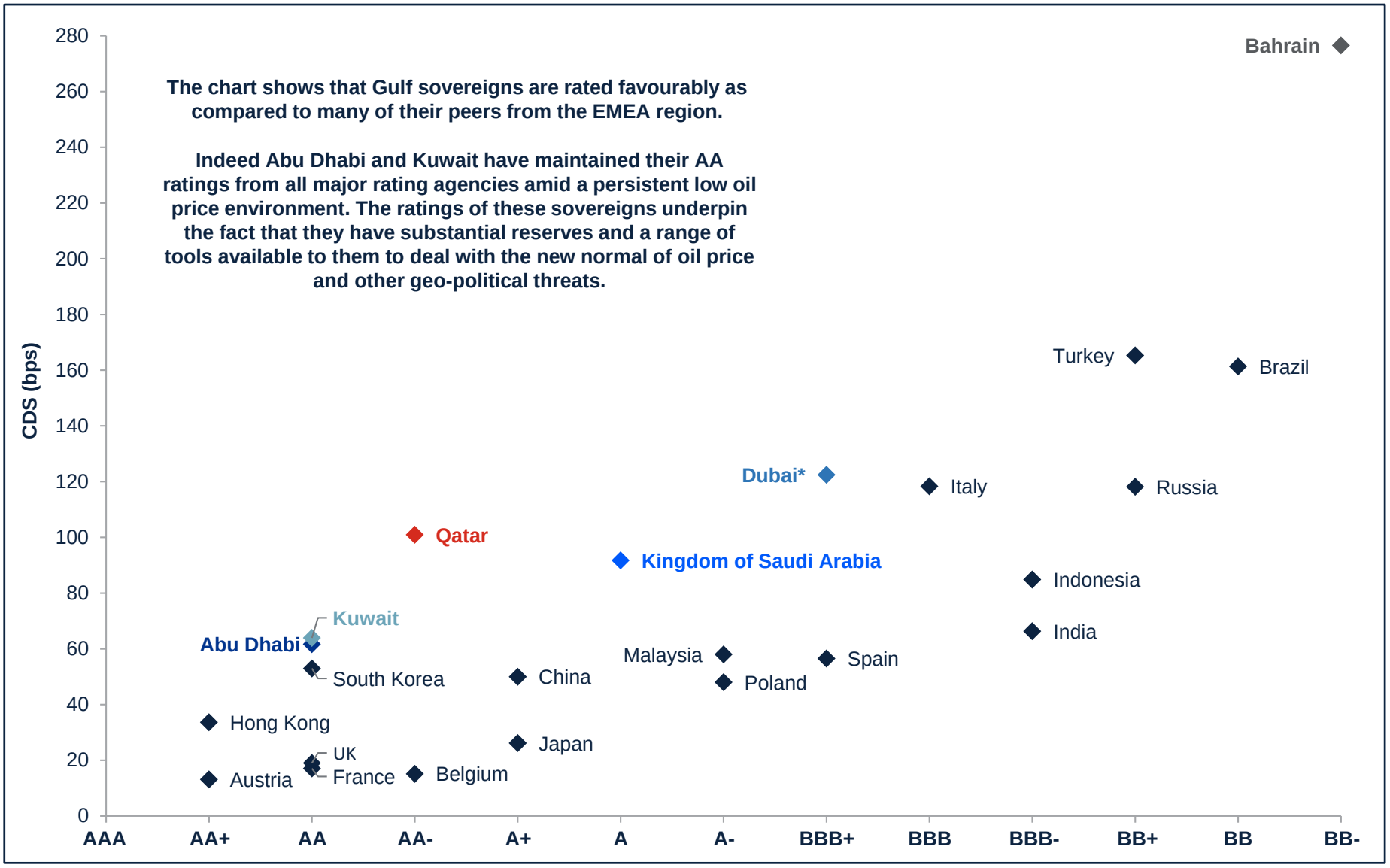
* **Notes:** Yields as on 29-Dec-2017; Composite rating - please refer Appendix for definition and calculation method; Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to DEWA (BBB+) & Emirate of Sharjah (BBB+); Source: Bloomberg/FAB

GCC sovereign bonds vs EM peers – 30Y relative value



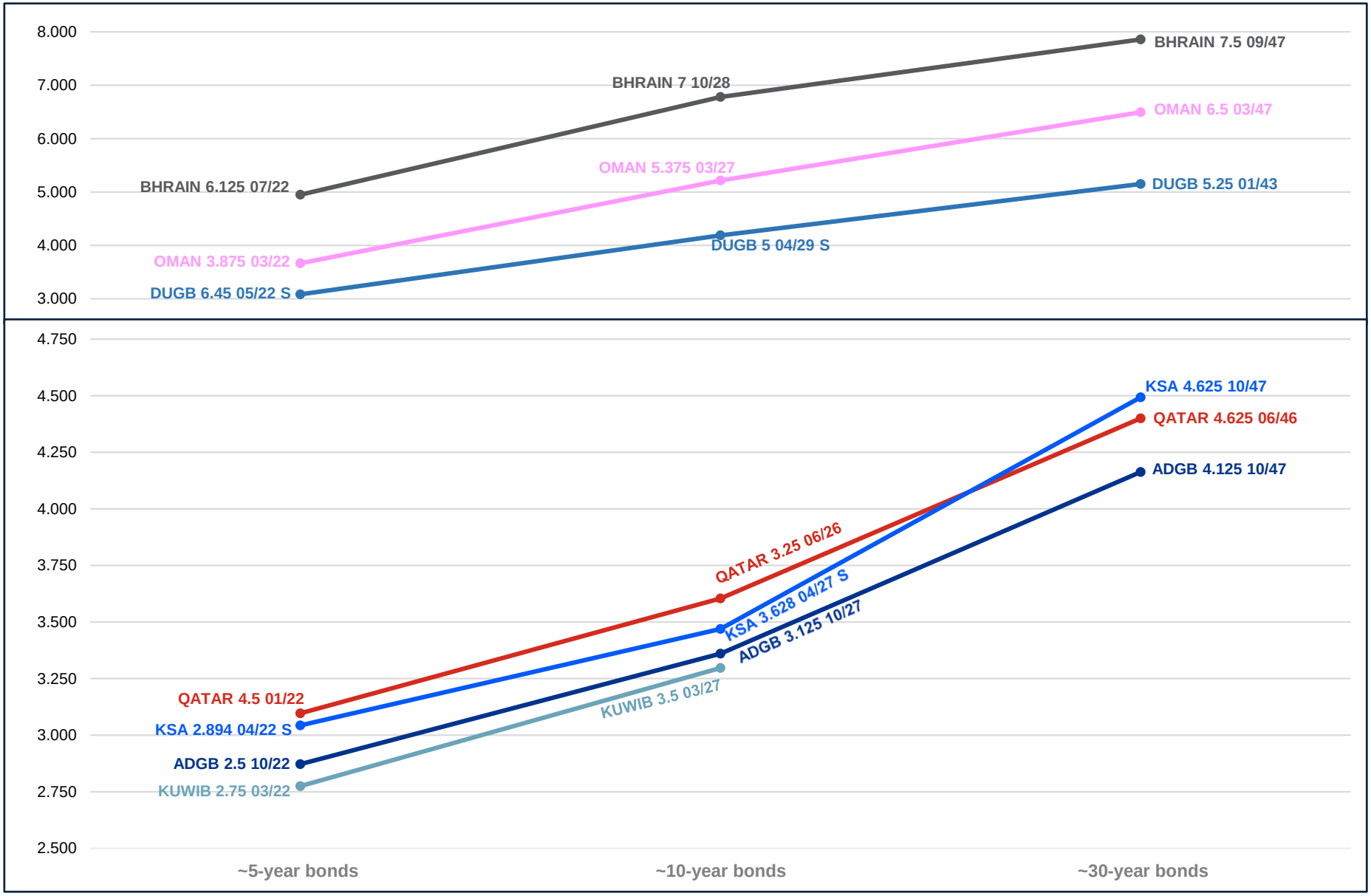
* **Notes:** Yields as on 29-Dec-2017; Composite rating - please refer Appendix for definition and calculation method; Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to DEWA (BBB+) & Emirate of Sharjah (BBB+); Source: Bloomberg/FAB

GCC sovereign credit ratings & CDS spreads versus peers



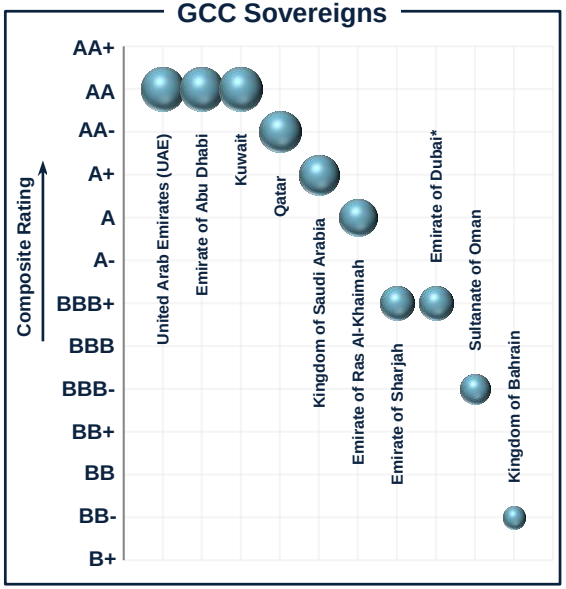
Notes: * X-axis represents the composite rating (please refer Appendix for calculation method); Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to DEWA (BBB+) & Emirate of Sharjah (BBB+). The ratings have been arranged from higher to lower starting from 'AA', followed by 'AA-' and so on; CDS levels are for 29-Dec-17 & in basis points; Source: Bloomberg/FAB

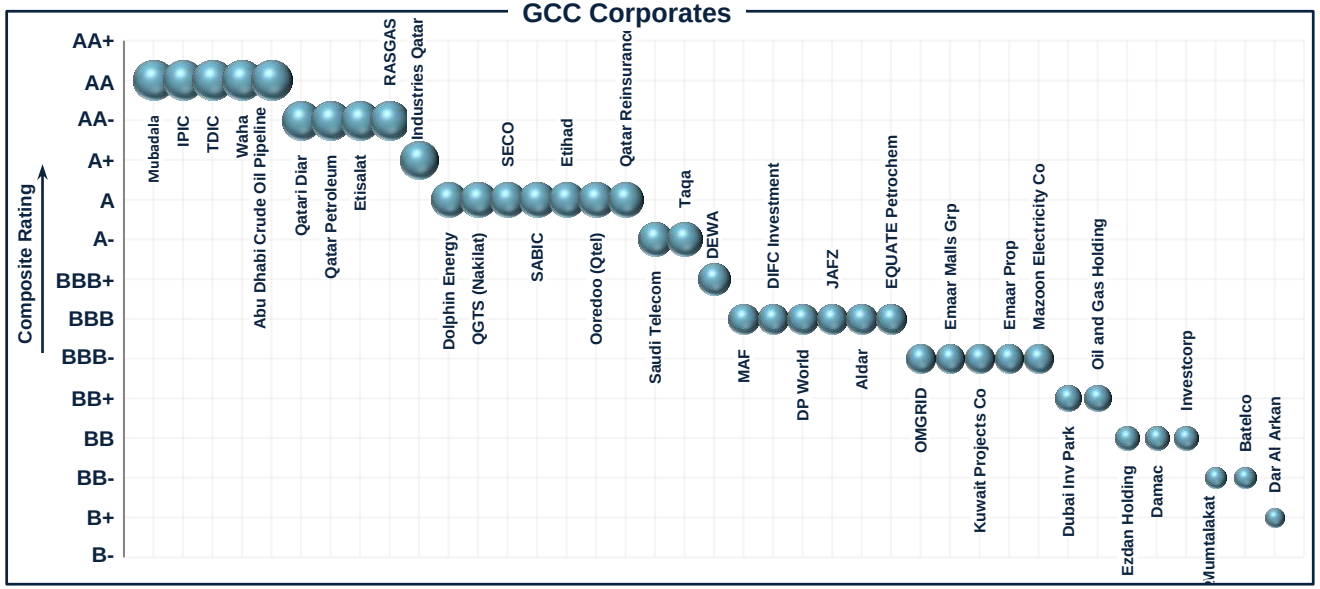
GCC sovereign curves

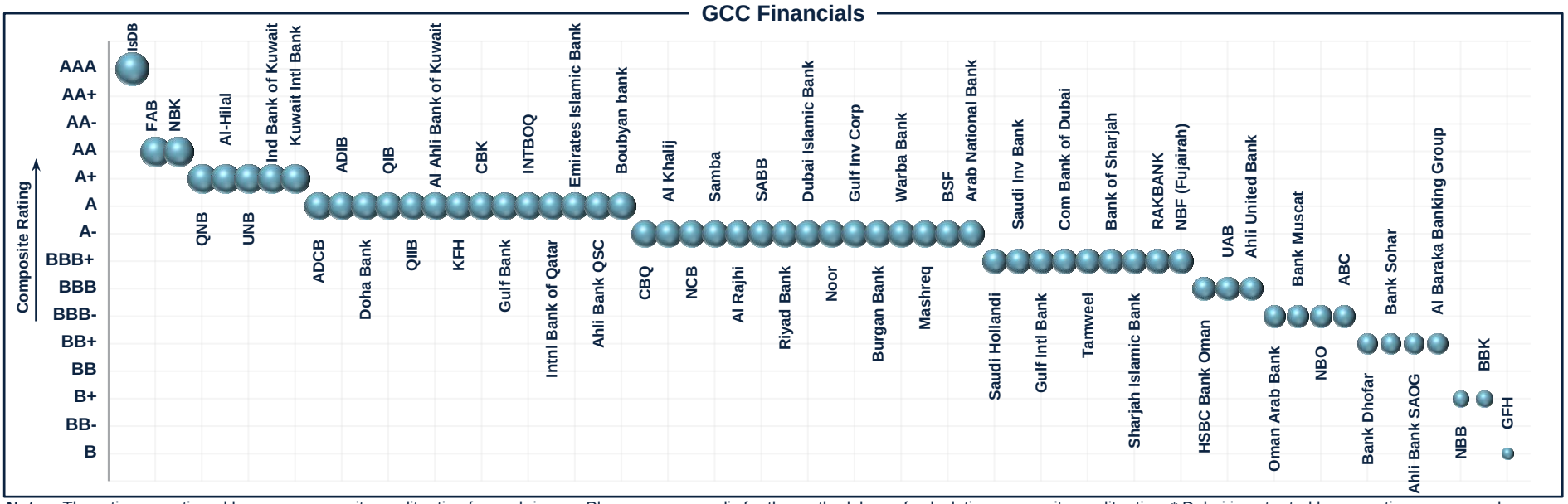


Notes: Curves as on 29-Dec-2017; "S" in the ticker indicates that the bond is Islamic (sukuk); Source: Bloomberg/FAB

GCC credit quality at a glance



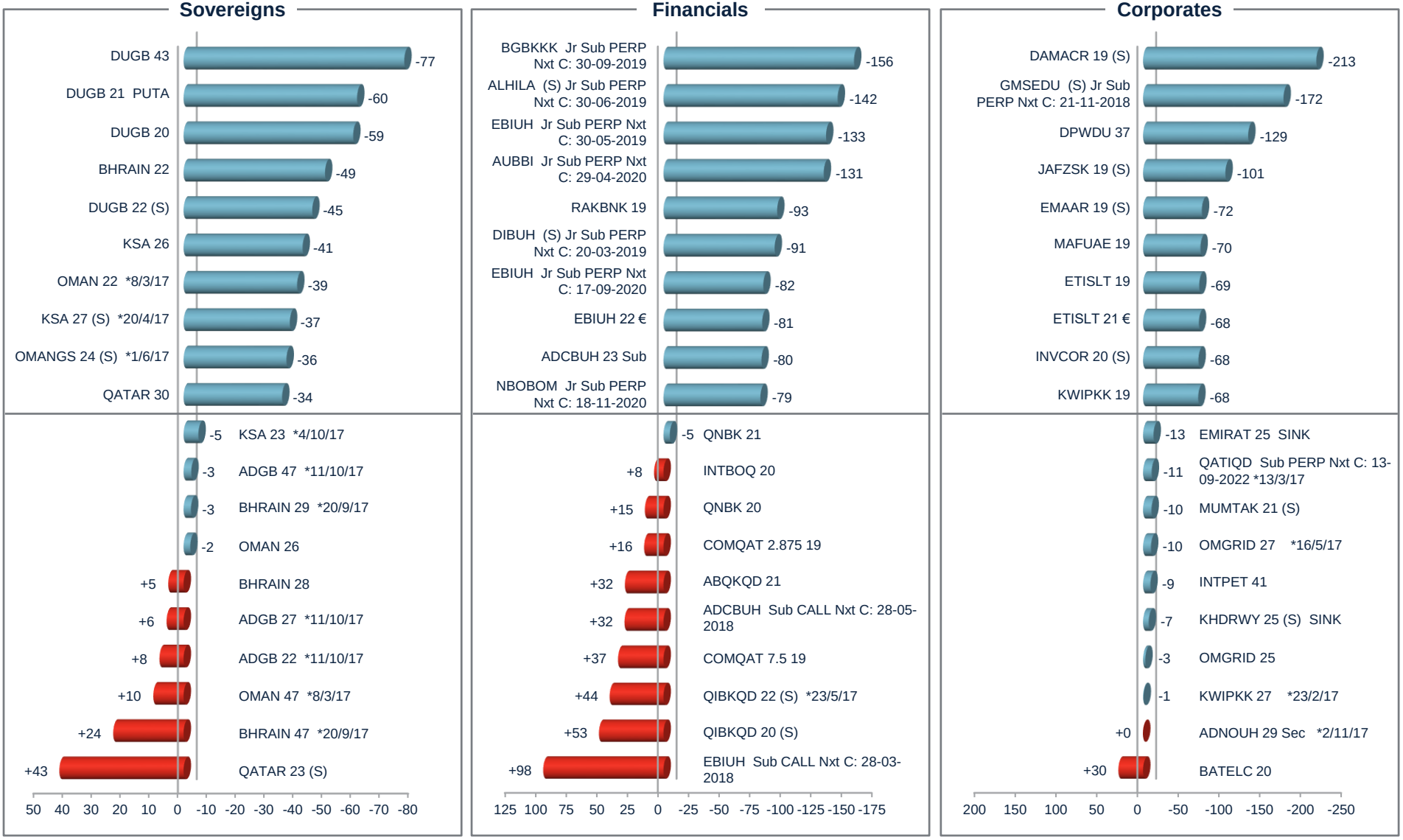




Notes: The ratings mentioned here are composite credit rating for each issuer. Please see appendix for the methodology of calculating composite credit rating; * Dubai is not rated by any rating agency and we have assigned a proxy rating of 'BBB+' based on its fundamentals with a relative comparison to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

GCC spread performance summary – FY 2017

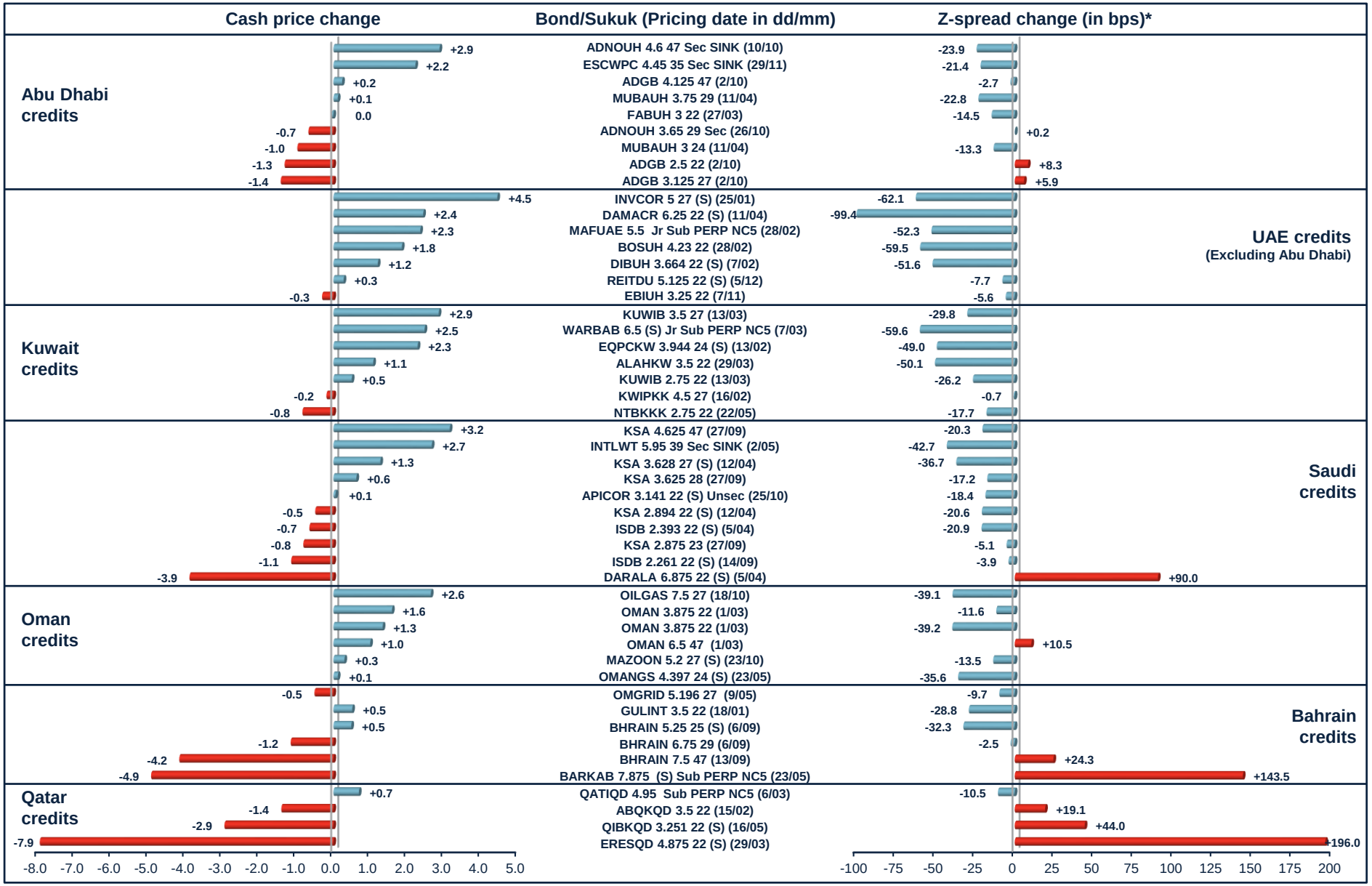
Top 10 / bottom 10 bond/sukuk performers (z-spread, bps) in each category from 30th Dec 2016 to 29th Dec 2017



Notes: (1) We have used a list of GCC public debt which are maturing in 2019 or beyond and for which FAB trading desk provides market price; (2) (S) in the ticker indicates Sukuk; (3) All bonds/sukuks are $ denominated unless any other currency is highlighted in the ticker. (3) 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", "Puta", & "Sink" respectively; (4) * highlights spread change from the 1st settlement date of the bond as it was issued in 2017; Source: FAB/Bloomberg

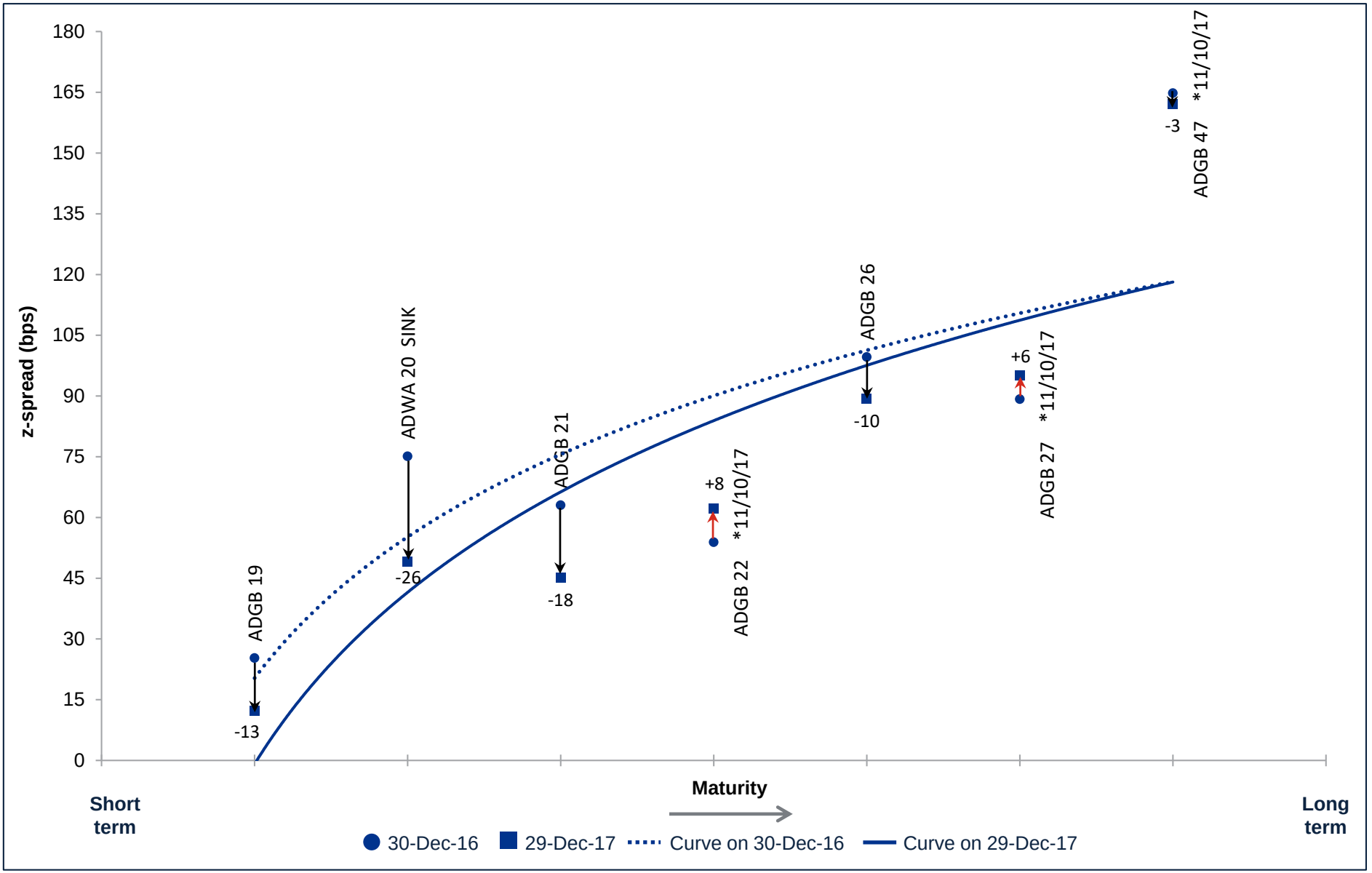
GCC's major primary deals in 2017 and their performance

Secondary market performance since issue (change in z-spread and cash price since issue till 29-Dec-17)



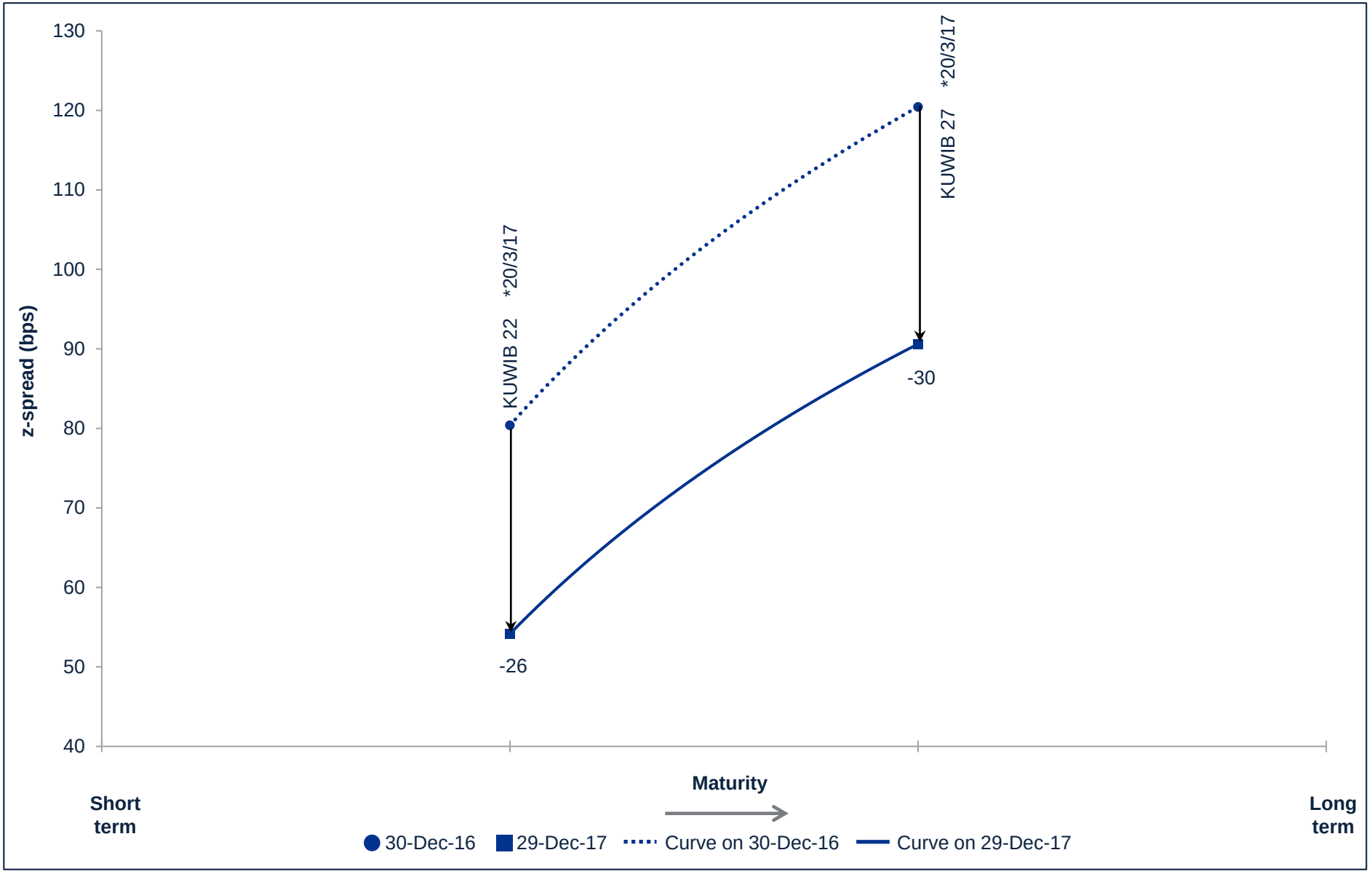
Notes: (S) in the ticker indicates Sukuk; All bonds/sukuks are US$ senior unsecured debt of the issuer unless an abbreviation for the debt type is highlighted – e.g – "Unsec" = Unsecured debt; "Sub" = Subordinated; "Sr Sub" = Senior Subordinated; "Jr Sub" = Junior Subordinated; "Perp" = Perpetual; Callable, Puttable and Sinkable highlighted as "Call", "Puta", & "Sink" respectively; Source: Bloomberg/FAB

Sovereigns spread performance – Abu Dhabi



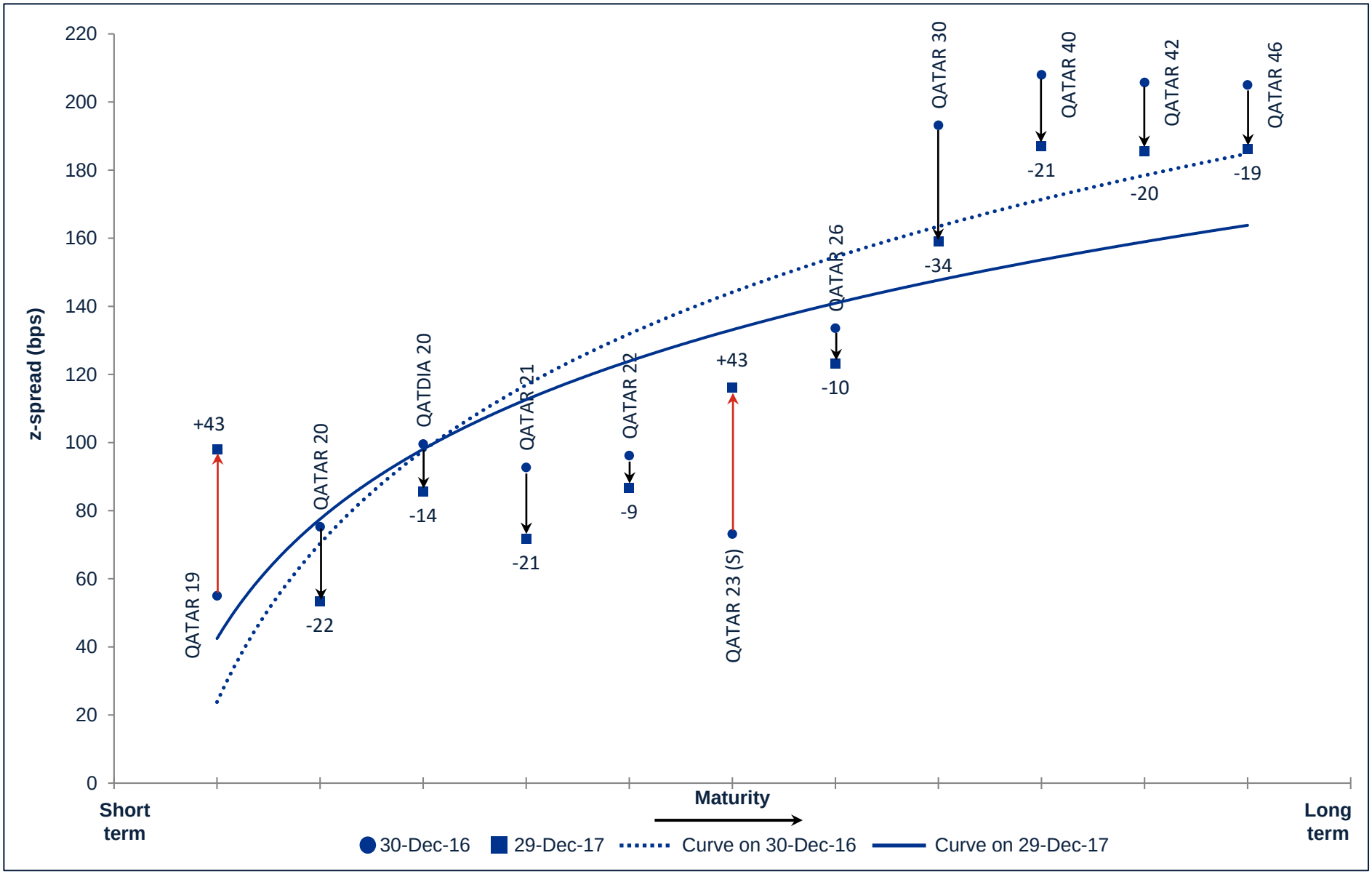
Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2017; Source: FAB/Bloomberg

Sovereigns spread performance – Kuwait



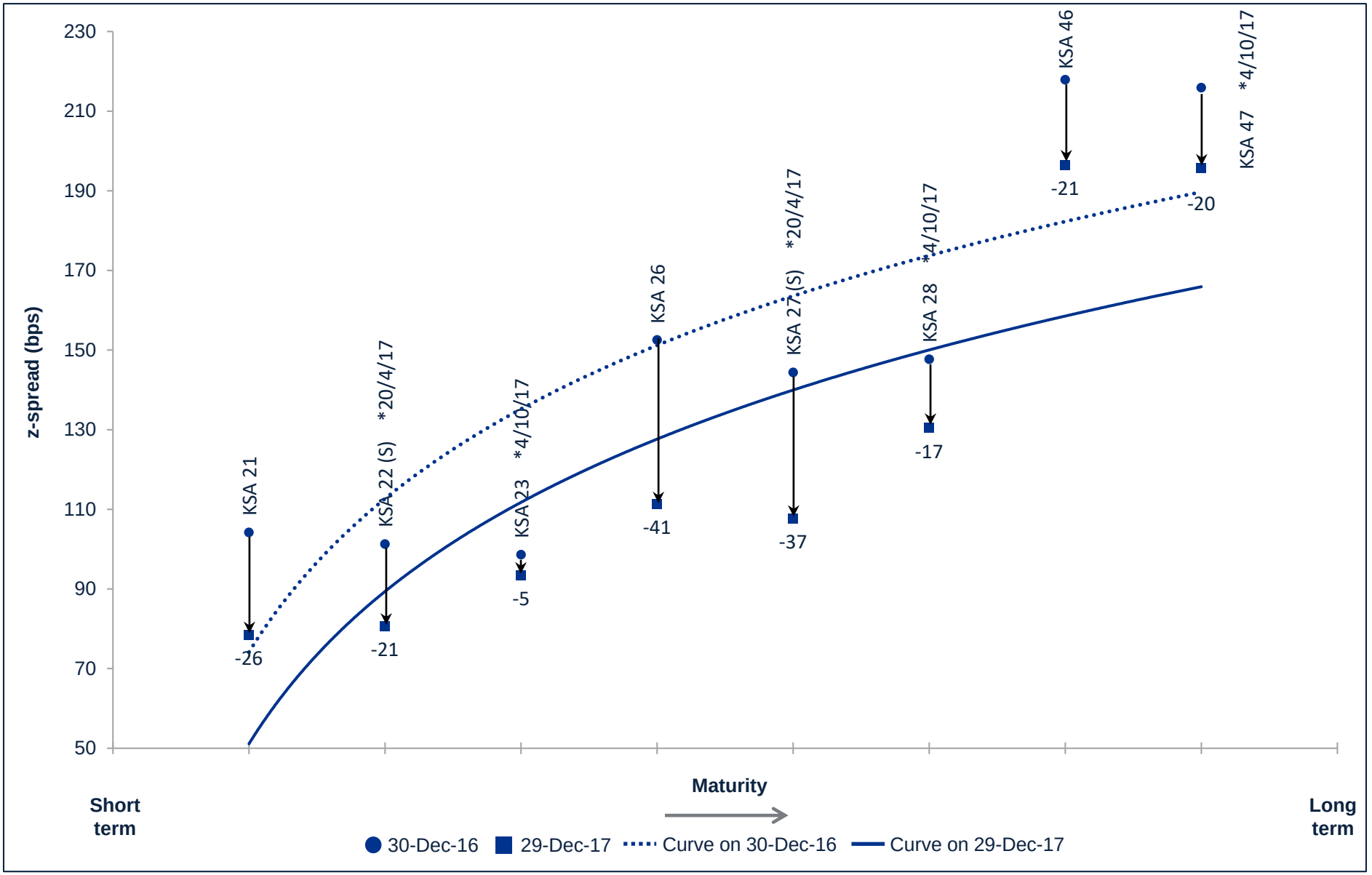
Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2017; Source: FAB/Bloomberg

Sovereigns spread performance – Qatar



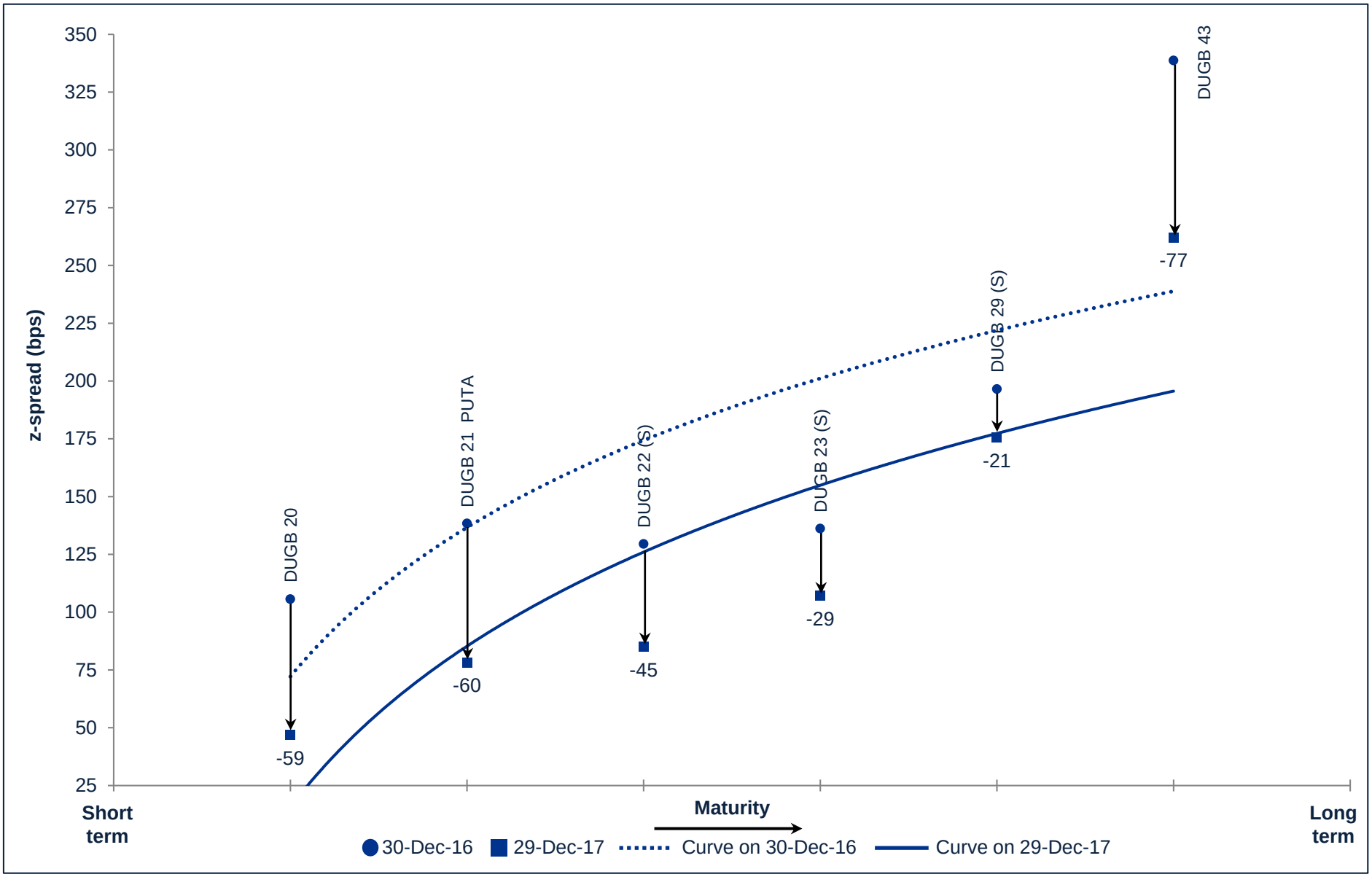
Notes: If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Saudi Arabia



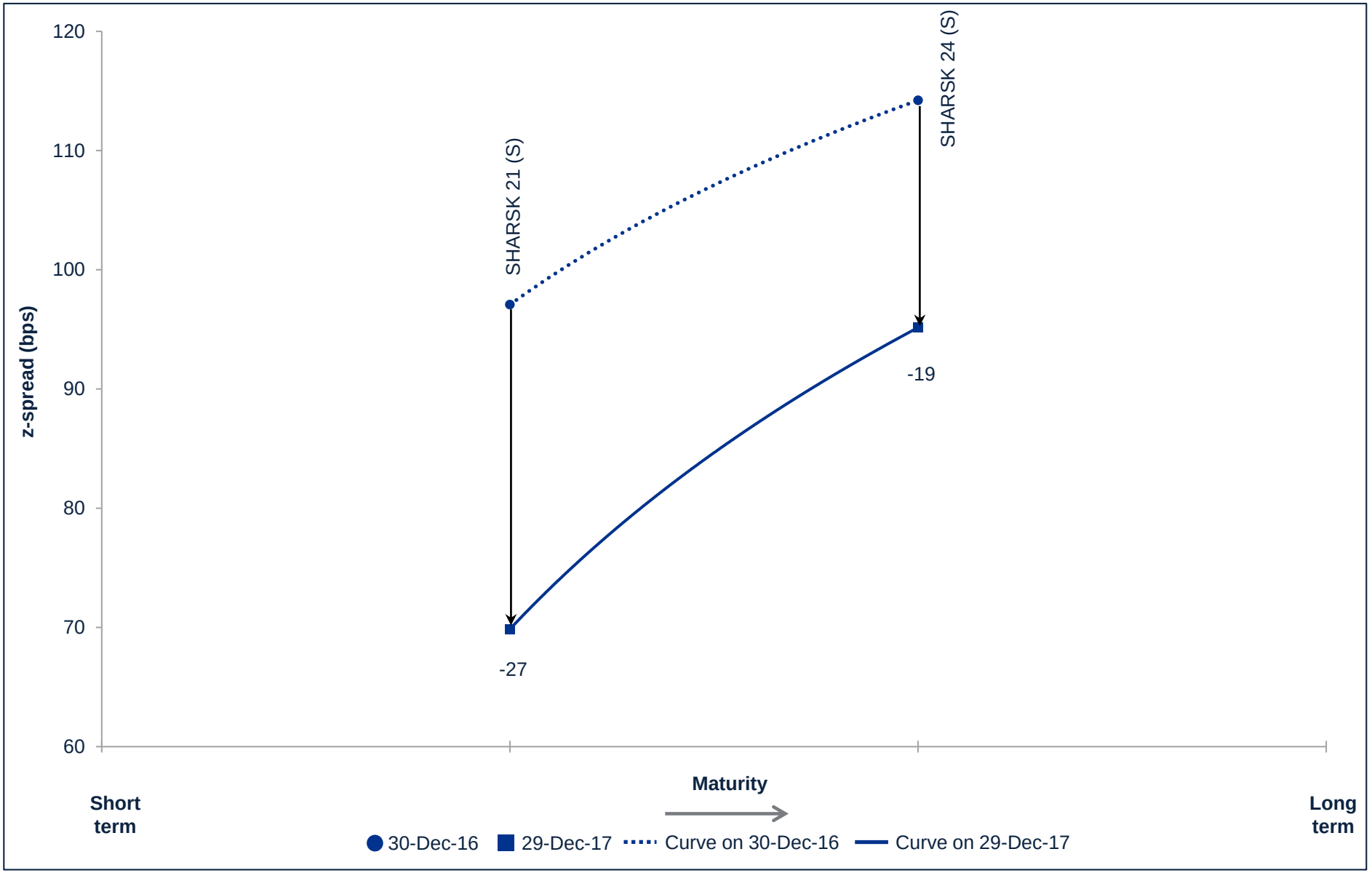
Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2017; If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Dubai



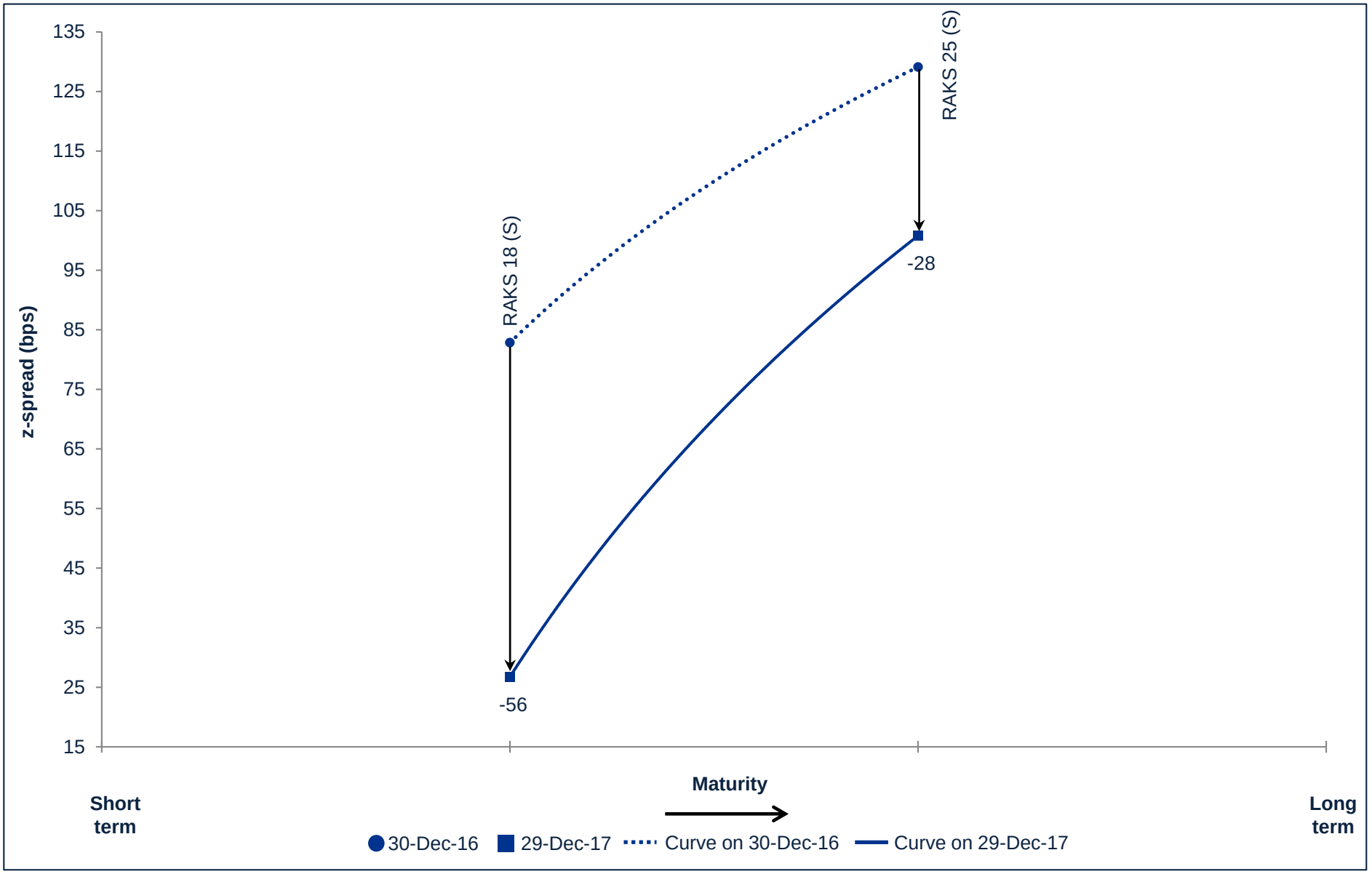
Notes: If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Sharjah



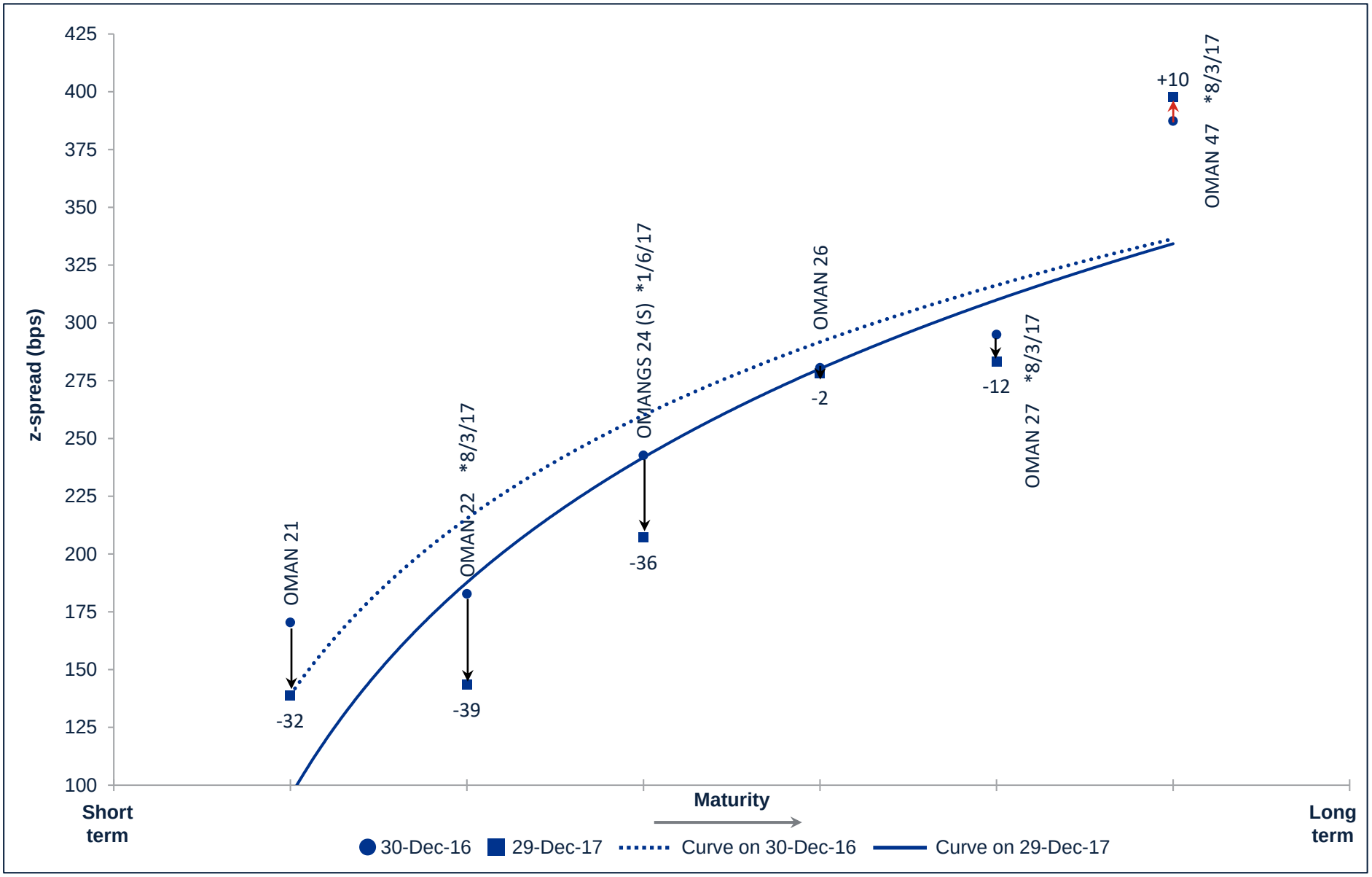
Notes: If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Ras Al Khaimah



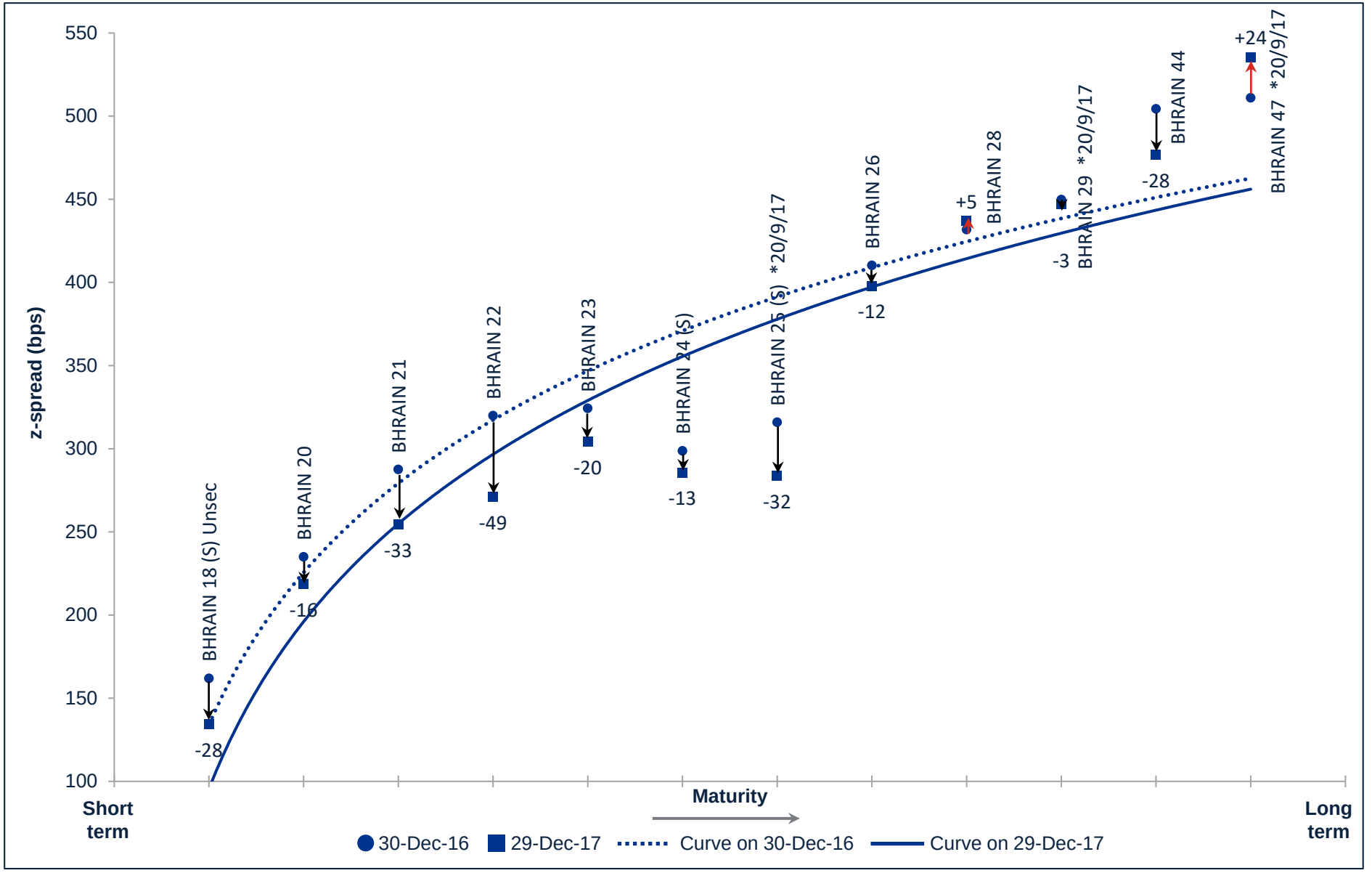
Notes: If "Sukuk" the ticker contains "(S)" next to the maturity year; Source: FAB/Bloomberg

Sovereigns spread performance – Oman



Notes: * Highlights spread change from the 1st settlement date of the bond as it was issued in 2017; 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 2017; 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”.

Source: Bloomberg/FAB

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