Bond binge to tackle deficits

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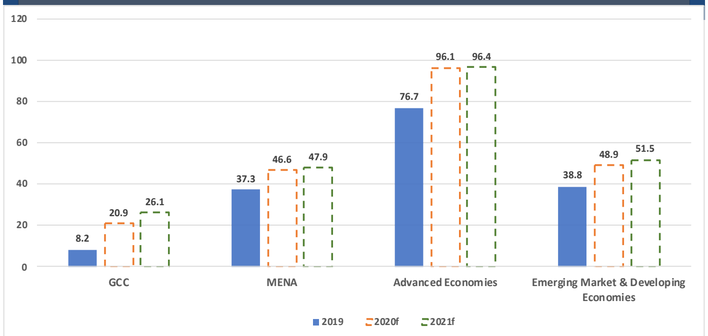
- **Driven by the increasing need to fund widening fiscal deficits, MENA's appetite for sovereign debt issuance will remain high, with sovereign sukuk issuance, in particular, expanding in the rest of this year.**
- **Volatility in GCC yields will be influenced by the longevity of the pandemic, by oil price stability, and by how swiftly economic wheels start to turn again.**
- **We expect yields to drift higher if the GCC's fiscal and external balances remain under pressure and if sovereign credit ratings continue to be downbeat.**

GCC Debt: Issuance at an all-time high

This year's debt issuance across MENA reached more than USD 93B in October -- an all-time high for a 10-month period and an increase of 8% YoY to date. With interest rates low and likely to remain so, we expect debt issuance to stay strong, at least until mid-2021. It will be driven by increased financing needs arising from the pandemic and from a longer-than-expected period of low oil prices, both straining government budgets.

- For the most part, GCC governments this year have responded to the pandemic by opting to borrow rather than liquidate assets to fund their fiscal deficits.
  - We expect GCC debt issuance will cover around 60% of the USD 490B government deficit needs in the coming three years. Saudi Arabia, Oman, Qatar and Bahrain are likely to fill most of their financing gaps through debt.
  - Kuwait and Abu Dhabi are more likely to draw down assets, although if a new debt law in the former is approved, we expect to see issuance in the coming quarter.
- Debt issuance in the GCC this year has been heavily dominated by sovereign and quasi-sovereign paper, with the bulk fuelled by Saudi Arabia at USD 32B and the UAE at USD 26B.
  - So far, GCC sovereigns have leveraged lower funding costs and issued longer debt maturities, with an average of 30 years.
    - The low interest rate environment is due to the global impact of liquidity injections by the European Central Bank and US Federal Reserve.
  - Key issuance this year includes a 40-year USD 7B three-tranche Saudi sovereign Eurobond issued in April, a USD 4B Eurobond from the UAE's quasi-sovereign Mamoura Diversified Global Holding, and a 50-year USD 5B tranche by Abu Dhabi.
  - The latter, issued earlier in September, is the longest term for a bond offering by a GCC sovereign to date. This reflects Abu Dhabi's banking on its ability to deliver long-term growth.
    - It attracted strong global demand with international investors accounting for 95% of the geographical allocation.
- While we expect the majority of external borrowing by the GCC to remain in the form of conventional bond instruments, the pace of shariah-compliant sukuk issuance in the Gulf has remained strong, certainly compared with the lagging rate of global sukuk issuance.
  - The volume of sukuk issuance in the GCC is expected to increase by 43% YoY to reach USD 94B by the end of the year.

Figure 1 – Debt Ratio by region (% of GDP)[1]



  - Sovereign issuance in H1 was broadly flat, mainly due to the complex requirements for sukuk compared with conventional debt.[2]
  - During H1, global sukuk issuance reached USD 77B, of which GCC issuers accounted for USD 28B, a 7% YoY increase from same period last year.
  - This was mainly driven by Saudi Arabia, whose sukuk issuance picked up following the uptick in activity and capital outflows when lockdown measures were eased.
    - The kingdom's sukuk issuance is expected to grow by around USD 8B this year to USD 27B.
  - Oman has also been active in the sukuk market this year. In September, it completed a USD 2M Omani riyal-dominated sukuk -- its third issuance under the sovereign sukuk programme established in 2019.
- Given the high financing and refinancing needs coming from mounting fiscal pressures, issuance will, perforce, raise the GCC's total outstanding debt. The total is expected to reach 20.9% of GDP this year, an around 155% YoY increase from last year.
  - These sovereign debt levels remain manageable for the GCC, and compare well with EM debt ratios, which explains the global appetite

Egypt: Investor interest rallies, again

Investor sentiment has turned in Egypt's favour, partially compensating for the loss in FX from tourism and remittances. IMF funding, including a USD 2.8B emergency financing loan, along with the Central Bank of Egypt's ability to stabilise the EGP against the USD, have restored confidence and helped reverse its two-year long inverted yield curve.

- While Egypt saw its largest ever capital outflows in Q2, there has since been a return to its local market. This is mainly because Egypt is offering some of the highest carry trades among emerging markets, with short-term debt yielding around 13%. This is paper that global money managers are familiar with.
  - Foreigners now account for 9.4% of total local debt holdings, up from 5.2% at the end of June. This foreign investor component is also something Egypt has attracted before.
  - The Ministry of Finance is once again shifting its market approach to issuing longer-maturity debt to take advantage of lower interest rates.
  - This is expected to ease government borrowing costs, with overall debt expected to reach 78.8% of GDP this year -- a 6% YoY increase.
    - Bond issues, compared with shorter-term bills, accounted for 71% of Egypt's net local issuance at the end of Q3 this year compared with 20% in the previous quarter.
- We expect international appetite for Egypt's bond market to remain strong under the current macro management framework, and with the IMF programme as an anchor.

[1] Arabia Monitor; IMF.

[2] Sukuk structuring requires special-purpose vehicles to meet borrowing conditions, with certain structures requiring the provision of physical assets to secure the borrowing.

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