

Debt markets

GCC: Yields rise on US rate hike expectations; issuance flat

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Increased expectations of a US rate hike has seen GCC bond yields pick up, while CDS rates continued to ease as sentiment improved during 2Q15. Yields appear to have shrugged off earlier concerns about fiscal vulnerabilities in the GCC; instead, yields are now being driven by the prospects of at least one increase in the US policy rate before the end of this year thanks to indications of a steady recovery in the US. Meanwhile, the stock of outstanding debt was flat, led by the financial sector in its compliance with new capital regulations. A robust economic outlook will likely see debt activity pick up this year.

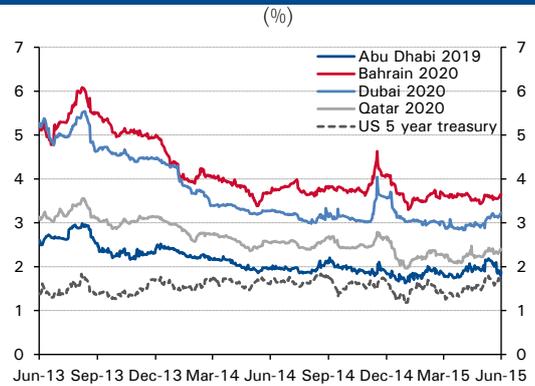
With fears of sharp slowdowns in GCC economic growth diminished, the increased prospects of a US rate hike before the end of the year is pushing GCC rates higher. Intentions to maintain healthy government spending levels despite lower oil prices, coupled with a robust economic outlook have helped assuage fears, bringing GCC rates down at the start of the second quarter of 2015. Yields climbed, however, in the latter part of the second quarter as a slew of positive US economic data increased the chances that the Federal Reserve will move to increase its key policy rate before the end of 2015. Sovereign yields on five year paper stood at 1.88%, 3.65%, 3.23%, and 2.38%, for Abu Dhabi, Bahrain, Dubai, and Qatar, respectively, by end 2Q15.

Credit default swaps (CDS) for all GCC countries continued their decline, reflecting the ongoing improvement in investor sentiment. The Dubai CDS benefitted the most from the resurging confidence, shaving off 21 points over the quarter, thanks to Dubai's steady fundamentals and fiscal prospects. Bahrain's CDS, which had seen its rate rise in 1Q15, experienced a decline of 12 basis points; still, the rate remains high due to a still vulnerable fiscal position. Abu Dhabi, Saudi, and Qatar each saw CDS rates drop by 10, 16, and 18 basis points, respectively.

GCC debt issuance was flat in 2Q15 compared to the previous quarter, slowing net growth in the stock of debt to 1.48% year-on-year (y/y). Outstanding debt saw a net increase of only \$4 billion to \$269 billion. The issuance of fresh debt remains weaker than a year ago, at \$9.1 billion; once again, weaker issuance by the non-financial sector was part of the reason. The financial sector continued to lead issuance activity in 2Q15 as more banks are complying with new capital regulations. Meanwhile, public sector issuance was led by Oman.

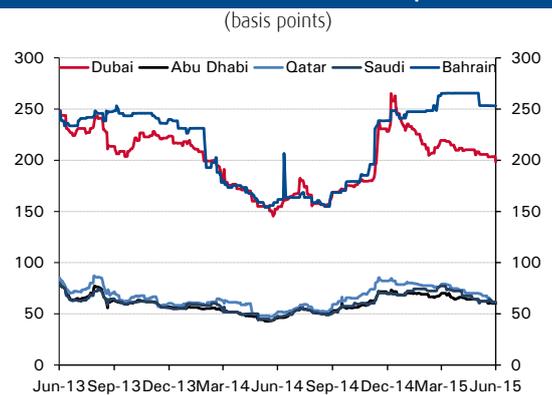
GCC debt issuance is still expected to recover this year, with borrowing needs likely to rise. In the current environment of lower oil prices, governments are expected to issue debt to finance rising fiscal deficits. The region's robust economic outlook and substantial capital spending plans, means private borrowing needs are expected to remain large.

Chart 1: GCC sovereign yields



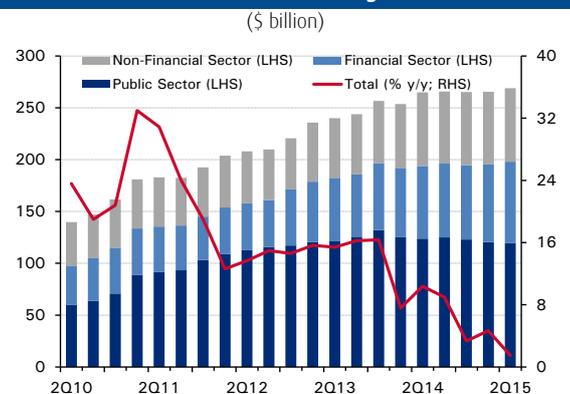
Source: Thomson Reuters Datastream

Chart 2: GCC credit default swaps



Source: Thomson Reuters Datastream

Chart 3: GCC outstanding debt



Source: Zawya

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