

MENA ASSET MANAGEMENT

MENA BONDS & SUKUK MARKET

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Special article on the

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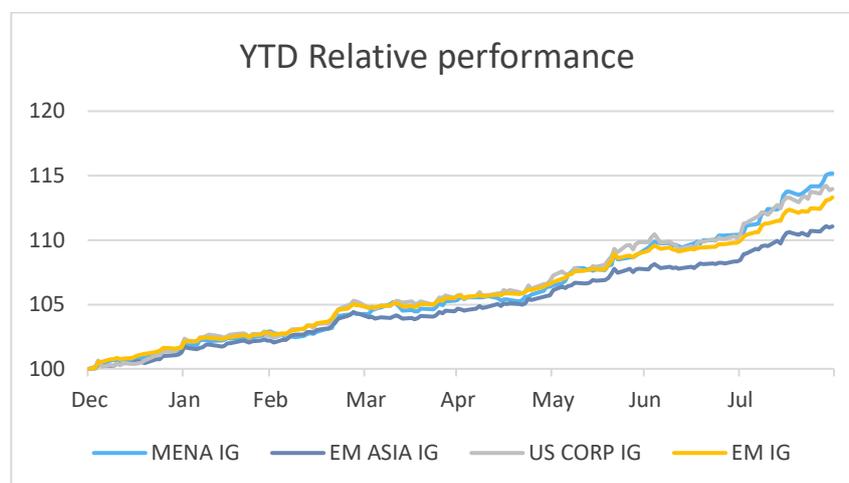
MENA Sovereign bonds and Sukuk constitute nearly 20% of EM index following GCC inclusion.

GCC debt market on track for its best yearly performance in a decade.

Outstanding performance despite regional challenges

The GCC international bond market is on its way to post its best performance since 2010. As of end- August 2019, the Bloomberg Barclays GCC Index, which tracks bonds and Sukuk issued by GCC entities rated as investment grade, was up 15.2% on a year-to-date basis. A large part of this extraordinary performance resulted from the sharp drop in yields globally. It is also the direct result of changes in the U.S. monetary policy, whereby cuts in the Fed benchmark rates are transmitted to all U.S. dollar denominated assets. In essence, the drop in yields on U.S. treasuries, whether from interest rate cuts or changes in economic outlook, lifts the price of USD bonds due to the inverse relationship between interest rates and bond prices.

Furthermore, the GCC region's performance stands out from similarly rated global peers. For example, the U.S. investment grade corporate bonds index¹ rose 13.9% and the Emerging Markets (EM) investment grade index² rose 13.3% over the same period, a whole 1-2 percentage points lower than the GCC market. It is worth noting that this outstanding relative performance happened in spite of heightened geopolitical tensions in the region and stagnant oil prices, and came largely on the back of J.P. Morgan's decision to include five GCC countries into its flagship EM Index, the Emerging Markets Bond Index Global (EMBIG)

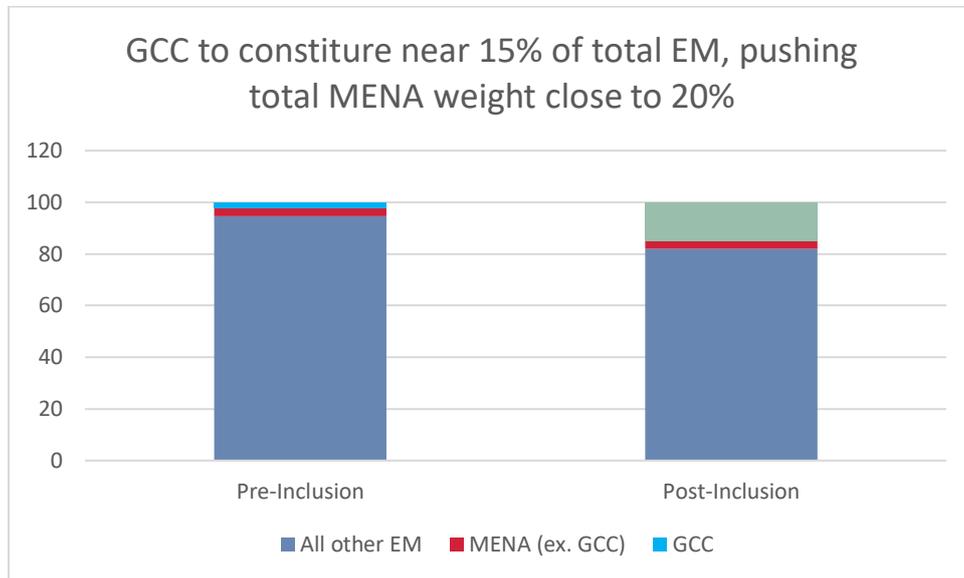


A strategic asset class that deserves investors' attention

Following last year's decision by J.P. Morgan to include five GCC countries into its flagship EM Index, the EMBIG, the total weight of the GCC increased to 15%, bringing the total weight of the MENA region in the index to around 20%. The inclusion translated into large inflows into the region's debt capital market, with estimates ranging from USD 25 to 30 bn. This additional demand helped compress GCC spreads, and pushed performance of the regional market to exceed that of its global peers.

The J.P. Morgan EMBIG Index suite was created nearly 20 years ago as growing investor demand for EM debt motivated the need for a broad benchmark. It is considered the most widely tracked index by EM debt investors. The GCC inclusion came as a recognition of the growing size and hence relevance of the market. This makes it hard to overlook the region by any well-diversified multi-asset global portfolio going forward.

The inclusion has additional positive consequences. With greater participation from foreign investors, the investor base of the regional debt market becomes broader. This enhances the market's ability to absorb a significant increase in bond issuance with relatively limited price distortion.

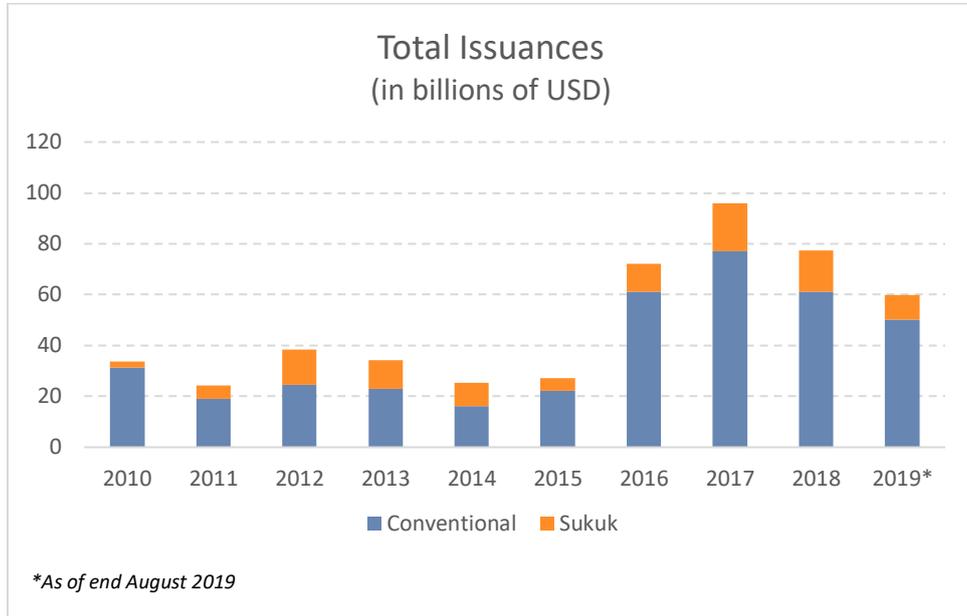


A market poised to grow

There is a wide market consensus that, over the foreseeable future, bonds and Sukuk issuances in the region will remain elevated given the mismatch between budgetary revenues and expenditures. Fiscal deficits have widened as many GCC economies embarked on ambitious capital expenditure programs to boost economic growth, and engaged in bold steps to diversify their economies away from oil. These steps led to an increase in borrowing--encouraged by low-interest environment--and in the total stock of debt.

Sukuk issuances are also on the rise, as economies seek to diversify their funding mix and develop the Islamic debt market. Sukuk issuances in the international dollar market amounted to around 20% of the total GCC issuances in the last two years, up from 15% in 2016. Around USD 45 billion worth of Sukuk were issued since 2017.

Looking ahead, one of the main challenges for regional economies will be to balance the need for public spending with debt sustainability. The average debt level of GCC economies measured against their GDP increased over the past three years, but still remains lower than developed countries.



1. Bloomberg Barclays U.S. Corporate Total Return Index
2. Bloomberg Barclays Emerging Market, Investment Grade