Markets Outlook

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Invest AD
شركة أبوظبي للإستثمار
Abu Dhabi Investment Company

About Invest AD

Invest AD is an investment company that offers institutional investors access to high-growth opportunities in the MENA region.

Owned by the Abu Dhabi government, the company benefits from an extensive international network, established over three decades and spanning governments, business leaders, and regulators.

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We implement international best practice in governance throughout all our operations, while offering flexibility in investment – whether through funds, tailor-made products, or long-term partnerships.

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Inside:

All eyes on Saudi Arabia's massive US$ 17.5 billion bond sale

Focus

What does Saudi Arabia's record bond issuance mean for the GCC region?

1. What does the bond sale mean for Saudi Arabia and its budget?

The US$ 17.5 billion Saudi Arabia bond is a landmark deal, in that it's the largest ever emerging markets sovereign bond issue (exceeding Venezuela's US$ 16.5 billion bond sale in April). For over a decade, until mid-2014, crude oil prices averaged in excess of US$ 85 per barrel, heralding a period of self-funded economic expansion and high government spending, while boosting accumulated foreign reserves to around US$ 740 billion. The sharp decline in the price of crude since 2014 has upended this, with the budget turning to a deficit of 15 percent in 2015. While the government embarked on a raft of austerity measures to limit the budget deficit, including subsidy and spending cuts, it has also significantly drawn on its foreign reserves, reducing these by nearly US$ 200 billion to US$ 550 billion by July 2016. With another deficit of an estimated 13 percent in 2016, it was inevitable that the Kingdom had to consider other sources of funding such as international debt. The US$ 17.5 billion raised is likely to help finance around a third of next year's budget deficit, and will slow down the draw on foreign reserves.

In the present environment of historically low, and even negative, yields in developed markets, Saudi Arabia successfully tapped strong investor thirst for high yielding assets, as evidenced by the diverse investor base. The bond sale attracted Asian central banks, European pension funds and insurance companies, many of which were especially interested in relatively long-dated debt to match their long-dated liabilities as they grapple with funding gaps of their own.

2. Can Saudi Arabia afford to take on so much debt?

Yes, the country has significant headroom currently to take on debt. At the end of 2014, the ratio of public debt to nominal GDP stood at only 1.6 percent (public debt stood at US$ 11.8bn). This measure rose to 5.9 percent by the end 2015 (with outstanding public debt at US$ 37.9 billion). This is relatively very low compared to developed and emerging market sovereign debt, and warning signals will only really start to sound if the debt-to-GDP ratio is well above 50 percent.

The government has been raising debt from the domestic banks this year, and in April it borrowed a further US$ 10 billion in loans from a consortium of international banks. Following the US$ 17.5 billion international bond sale, total public debt would have risen to US$ 90.5 billion, and in a sign of the government's intent to tap both domestic and international markets in the next few years, the government expects debt-to-GDP to reach 30 percent by 2020. While 30 percent represents a significant increase from a low base, this is not a particularly worrying in the context of the government's ability to service that debt, and when compared to most developed or key emerging economies.

3. What does the Saudi Arabian issuance mean for other Gulf countries, and the regional bond market?

2016 has been a very active year for Gulf sovereign issuers, with all Gulf Cooperation Council (GCC) countries, except Kuwait, raising debt in international markets. Despite the economic impact of lower crude prices on the regional economies, the timing of such issuances this year has been fortuitous, coming at a period of historically low interest rates in developed markets, which has underpinned the strong demand from yield-hungry international investors. This was illustrated by the enthusiastic demand for the Saudi Arabian issue, with an order book of US$ 67 billion. It was therefore priced at a yield below initial indications.

Given most GCC countries continue to have low debt-to-GDP ratios (well under 50 percent), especially from highly rated issuers such as Abu Dhabi, Qatar and Saudi Arabia; there is further room for additional issuance in the medium term.

The Saudi Arabian bond, having been preceded by issuances from Qatar, Abu Dhabi, Oman, and Bahrain governments earlier this year, will likely add liquidity to the regional bond market, and will help raise recognition among international investors. In addition, given the issuance was conducted through three tranches with different maturities, benchmark pricing for government debt has been achieved across the yield curve. This should help Saudi corporates to issue and price new debt across similar maturities.

4. What can we expect in the coming months?

We can broadly expect continuing demand for bonds issued by GCC governments given the "sweet spot" that GCC government bonds occupy -- sitting between low-yielding developed markets bonds and more risky traditional emerging markets bonds.

However, given forthcoming supply, and with expectations for rising interest rates, investors will become more demanding and future issues will probably be priced at relatively higher yields than issuances in the first nine months of 2016.

Mohammed Al Hashemi is the executive director of Invest AD Asset Management PJSC.

Equities

GCC

Investors remain cautious on regional equity markets, but recent events in Saudi Arabia have resulted in an improvement in sentiment. All eyes were on the Kingdom's massive US$17.5 billion bond sale, which was oversubscribed by a large margin with a final pricing that was significantly tighter than market expectations. The successful sale was not only important from an economic perspective, with the proceeds likely to ease some of the country's short-term liquidity pressures; it also demonstrated Saudi Arabia's ability to tap global markets for funding on attractive terms, if needed, and showed investor confidence in the country's long term prospects.

Some of the enthusiasm surrounding the bond sale may spill over into Saudi equities. Markets have been rattled recently, with consumer stocks taking a major beating as announcements of a cut in monthly allowances of employees in the public sector, and further government spending cuts sparked investor fears of a downturn in demand and the private sector facing a 'perfect storm' of lower growth, reduced subsidies and more onerous regulation. Nonetheless the government's measures are likely to contribute positively to the economy in the longer term, and a number of stocks in the Kingdom have become attractive even considering the 'new normal' of tighter economic times. There are a number of companies that have shown encouraging signs of being ready to adapt to the new reality, and investors focused on buying these firms at the right valuation are likely to see healthy returns over a reasonable time frame.

In the immediate near term investor sentiment will be dictated primarily by international events such as the outcome of the upcoming OPEC meeting, the US elections, global central bank policy decisions and regional geopolitical developments. Looking further ahead we also expect companies' annual results and national budget announcements to have an impact on investor sentiment and market direction.

Market data as of October 25, 2016

Country/Region	Closing price	MTD	YTD	3M	1Y	3Y
S&P GCC	146.94	-0.37%	-2.50%	-3.23%	-9.36%	-11.39%
S&P Frontier BMI	90.02	0.09%	0.16%	2.13%	-5.52%	-12.81%
S&P Pan Arab	140.65	0.14%	-0.93%	-2.29%	-7.19%	-8.96%
MSCI Emerging Markets	918.25	0.17%	18.26%	5.58%	8.71%	-3.00%
MSCI World Total Return	4,690.99	-1.49%	4.12%	0.16%	1.85%	12.23%
MSCI EFM Africa Ex S.A.	454.27	2.57%	-1.15%	4.30%	-5.75%	-21.53%
Total return in local currency (MSCI)						
MSCI UAE	131.49	-5.19%	6.59%	-4.63%	-2.54%	18.58%
Saudi Arabia	1,568.61	-1.03%	-11.75%	-8.00%	-16.65%	-20.67%
MSCI Kuwait	1,367.83	3.48%	-3.54%	3.87%	-7.69%	-25.16%
MSCI Qatar	823.57	0.40%	5.77%	-0.42%	-6.20%	6.32%
MSCI Oman	1,648.14	-3.52%	3.61%	-3.73%	-5.78%	-2.55%
MSCI Bahrain	190.50	0.70%	1.39%	-1.56%	-15.51%	-49.86%
Total return in USD (MSCI)						-
MSCI Egypt	232.76	9.14%	25.76%	13.29%	18.75%	36.67%
MSCI Turkey	364,364.40	-4.90%	7.60%	3.66%	-4.43%	-30.08%
MSCI Jordan	229.97	-0.70%	-9.56%	-5.73%	-6.94%	-14.28%
MSCI Lebanon	0.48	11.85%	10.98%	10.52%	18.12%	17.69%
MSCI Morocco	30.72	1.69%	23.84%	3.74%	20.55%	0.80%
MSCI Botswana	76.66	0.57%	-14.03%	-1.71%	-21.98%	-16.97%
MSCI Ghana	461.78	5.76%	-14.55%	-5.39%	-7.79%	-54.03%
MSCI Kenya	18.30	2.83%	7.70%	1.25%	10.28%	6.83%
MSCI Mauritius	26.18	5.28%	6.66%	5.35%	3.95%	-11.83%
MSCI Nigeria	1.72	-0.44%	-35.16%	-1.82%	-39.75%	-59.38%
MSCI Tunisia	666.12	-2.42%	2.52%	0.24%	-4.67%	-7.81%
MSCI South Africa	96.54	-2.44%	22.18%	-1.95%	-0.81%	-6.48%
S&P Zambia	89.79	-1.79%	-19.02%	-0.82%	-13.51%	-52.66%

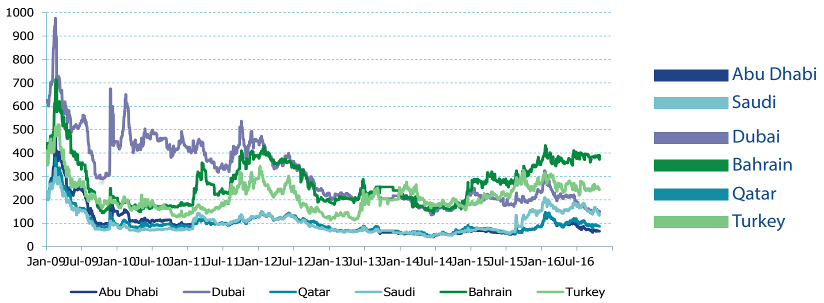
Source: Bloomberg

Fixed income

Regional credit markets have been singularly focused on the much anticipated mega bond issuance from Saudi Arabia. Markets had been speculating about the issuance from the start of the year and in the end, the actual issuance did not disappoint, in terms of pricing and size. The US$ 17.5 billion offering put Saudi Arabia ahead of the US$ 16.5 billion Argentina issue seen a few months ago to become the largest ever emerging market sovereign bond ever sold. The final book size exceeded US$ 70 billion, with strong demand from diverse global investors for an "A" rated sovereign issuer coming to the market after a very long gap. The initial pricing of T+160 bps, T+185 bps, T+235 bps respectively for the five-year, 10-year and 30-year tranches compared very favourably to the Qatar and SECO bonds and saw investors coming in with huge orders. The roadshows conducted in the United States and Europe were extremely well attended and gave an indication of the demand that could be expected from global bond funds, insurers and pension funds. The huge demand seen for the bonds resulted in a healthy tightening of the spreads across all tranches and the final issuance spreads were set at T+135bps for the five-year, T+165 bps for the 10-year and T+210 bps for the 30-year tranches. The total issuance size of US$ 17.5 billion was split between US$ 5.5 billion each in the five-year and the 10-year tranches and US$ 6.5 billion for the 30-year tranche. The huge issuance at the long end momentarily created a slightly defensive sentiment in the market. However, with the secondary market trading very well, especially in the long end, the sizes of the individual tranches were not of much concern to investors. The allocation to local markets was less than expected with only 10 percent allocated in the 5-year and 24 percent allocated in the 30-year bond. This led to steady demand in the five-year and 10-year tranches among local accounts. In the 30-year bond segment, the allocation to the Middle East was only 9 percent. The majority of the offshore allocation has gone to emerging market fund managers and pension funds, with very little allocated to private banks. This also resulted in very strong demand on the long end, and as a result, the 30-year bond rallied strongly in the secondary market.

The pricing and the secondary market performance of all the tranches of the Saudi issuance helped to create a strong boost for other secondary market bonds and CDS, with the rally led by Qatar, Saudi and Dubai sovereign/quasi-sovereign names. The Saudi benchmark CDS also witnessed a strong rally post the issuance as it traded in line with the spread compression seen in the cash bond markets. The positive sentiment in the market is expected to continue in the coming days as the accounts that were under allocated add to their positions in the secondary.

Sovereign CDS spreads



Source: Bloomberg

GCC CDS spreads

Sov CDS	Level	Wk (bps)	YTD (bps)
Abu Dhabi	67	-1	-26
Dubai	153	4	-81
Qatar	88	-1	-5
Saudi	135	-13	-21
FI & Corp CDS			
NBAD	88	-2	-22
ADCB	99	-4	-29
Emirates Bank	161	1	-38
Samba	202	0	10
TAQA	110	-2	-5
DP World	149	-2	-35

Source: Bloomberg

Market data as of October 24, 2016

Financials – senior	Maturity	Cpn	Bid	Ask	Bid sprd	Ask sprd	S&P	CCY	Type
ADCB	16-Sep-19	2.75%	101.25	102.00	118	91	A	USD	C
ADCB	6-Mar-23	4.50%	104.00	105.00	243	225	A-	USD	C
ADIB	29-Oct-49	6.38%	103.75	104.25	329	303	N.A.	USD	S
ALHILA	8-Oct-18	3.27%	102.13	102.63	106	80	N.A.	USD	S
AUBBI	29-Dec-49	6.88%	101.50	102.50	522	491	N.A.	USD	C
Boubyan	29-Dec-49	6.75%	106.63	107.13	387	375	N.A.	USD	S
Bank Muscat	3-May-21	3.75%	101.38	101.88	218	206	BBB-	USD	C
CBDUH	17-Nov-20	4.00%	103.38	104.13	190	171	N.A.	USD	C
COMQAT	24-Jun-19	2.88%	101.50	102.00	118	99	BBB+	USD	C
DIBUH	30-Mar-21	3.60%	101.50	102.00	200	188	N.A.	USD	S
EIBUH	31-May-21	3.54%	101.75	102.25	189	177	N.A.	USD	S
First Gulf Bk	14-Jan-19	3.25%	102.50	103.00	101	79	N.A.	USD	C
NOORBK	28-Apr-20	2.79%	99.50	99.75	177	170	N.A.	USD	S
NBAD	13-Aug-19	3.00%	102.25	103.00	105	78	AA-	USD	C
Natl Bk of Oman	7-Oct-19	3.13%	100.38	101.13	186	160	N.A.	USD	C
QNB	14-Feb-18	2.13%	99.63	100.38	100	41	A+	USD	S
Qatar Islamic Bank	27-Oct-20	2.75%	100.50	101.00	142	129	N.A.	USD	S
Aldar	3-Dec-18	4.35%	104.00	104.50	132	108	BBB	USD	S

Source: Bloomberg