FRANKLIN TEMPLETON

31 January 2021

Perspective from Franklin Templeton Fixed Income

GCC/MENA Bond Market Update

Summary

- Global equities fell back as volatility increased in January, but emerging market (EM) equities continued to advance. Fixed income assets mostly fell back though, as US benchmark yields rose further.
- The FTSE MENA Broad GCC (Gulf Cooperation Council) Issuers Index declined due to a rise in benchmark yields.
- Issuance levels picked up in January amid buoyant demand, which represented an increase of 70% compared with January 2020.
- Our outlook is still positive as we believe a cyclical rebound in economic growth is likely in 2021.
- We continue to monitor the risks presented in the current environment, but do not yet view areas currently experiencing market volatility as having an impact in our core markets. We believe that our current positioning is well suited for this backdrop.

Market Review

January 2021 saw an increase in market volatility as many equity markets declined in the second half of the month, in part on pandemic-related concerns, with prolonged lockdowns in some developed-market countries fuelling worries of further economic weakness.

Overall, equities declined as falls in developed markets outweighed broad gains in EMs. In fixed income, many markets stepped lower. The US 10-year Treasury yield rose 15 basis points (bps) in January, and government bonds overall, as represented by the FTSE World Government Bond Index, declined 1.28%. EM bonds (as measured by the JPMorgan Emerging Markets Bond Index Global Diversified (EMBIGD), which tracks hard-currency EM government bonds) slipped back 1.09%. Meanwhile, the FTSE MENA Broad GCC Issuers Index declined 0.49%, as higher benchmark yields more than offset the positive impact of tighter spreads.

In January, crude oil prices advanced overall, helped by a surprise additional output cut from Saudi Arabia and waning stockpiles in the United States. The move from Saudi Arabia—which announced it was going to cut production in February and March—came at the first 2021 meeting of the Organization of the Petroleum Exporting Countries and certain other significant producers (OPEC+). A gradual rise in production had been announced at the group's previous meeting in late 2020. However, there was a lacklustre finish to oil prices in January as concerns about the likely strength of a demand recovery resurfaced.

The International Monetary Fund (IMF) improved its global growth estimate for 2020. Its estimate was increased by 0.9 percentage points to a contraction of 3.5%, helped by an improvement in the second half of the year. The IMF also upped its forecast for 2021—by 0.3 percentage points, to 5.5%—due to the rollout of vaccines and supportive policies in key economies. It also expects the United States and China to post strong growth numbers in 2021—5.1% (an upward revision of two percentage points) and 8.1%, respectively. In the GCC region, the IMF now forecasts Saudi Arabia will grow at 2.6% in 2021, a reduction from its previous forecast of 3.1%.

Meanwhile, Oman amended its constitution to introduce the role of a crown prince for the first time. This change was introduced to help facilitate the process of the transfer of power. It also announced new decrees to establish a committee to evaluate the performance of senior government officials. Oman also reported its 2021 budget, which forecast a 14% drop in spending, amid a 19% fall in oil revenues (based on an oil price assumption of US$45 per barrel). Additionally, the country predicts it will raise 300 million Omani rials from the implementation of its 5% value added tax (VAT), which is due to be brought in on 16 April.

On the diplomatic front, Saudi Arabia, Bahrain, the United Arab Emirates (UAE) and Egypt restored diplomatic ties with Qatar and agreed to a "turning of the page" on their differences, following an embargo on the emirate that lasted over three years.

Saudi Arabia's purchasing managers' index (PMI) increased to 57 in December. This was the fourth consecutive month of expansion (as indicated by a PMI figure of 50 and above) and the highest level since November 2019, helped by new orders hitting one-year highs. However, employment contracted. UAE's manufacturing PMI also increased and moved into expansionary territory, rising from 49.5 to 51.2, the highest reading since August 2019. The rise in PMI activity was partly offset by employment, which remained in contraction. Overall, job losses were recorded in every month of 2020.

Dubai announced its fifth economic stimulus initiative, worth a total of 315 million UAE dirham (AED). Measures included extensions to fee exemptions and other measures from the previous stimulus packages. Dubai's support measures have now reached a total of AED 7.1 billion.

Market Data Change
31 December 2020–29 January 2021

Currencies	29 Jan 21	31 Dec 20	% Change
EGP	15.71	15.74	0.19%
PKR	160.14	160.19	0.03%
MAD	8.95	8.91	-0.42%
LBP	1,508.00	1,515.00	0.46%
TND	2.70	2.69	0.35%
MYR	4.04	4.02	-0.49%
IDR	14,030.00	14,050.00	0.14%
DXY	90.58	89.94	0.72%
EUR	1.21	1.22	-0.65%
JPY	104.68	103.25	-1.37%

Fixed Income Sukuk			
UST 10YR	1.07	0.91	0.15
DBR 10YR	(0.52)	(0.57)	0.05
MGII 10Y Index	2.75	2.79	(0.04)
DJ Sukuk	201.61	201.45	0.08%
FTSE MENA Bond—GCC Index	179.02	179.70	-0.49%
FTSE World Gov Bond Index	1,084.49	1,098.56	-1.28%
BarCap Global Agg	553.80	558.73	-0.88%
EMBIGD	984.36	995.16	-1.09%
Itraxx Crossover	268.74	242.60	26.14
CDX Emerging Markets	173.17	149.56	23.61

Equities	29 Jan 21	31 Dec 20	Total Return
All World	642.91	646.27	-0.44%
EM	1,329.57	1,291.26	2.99%
ASIA Pacific x-JN	1,447.13	1,437.14	0.70%
Europe	131.05	132.10	-0.73%
Dow	29,982.62	30,606.48	-1.95%
S&P 500	3,714.24	3,756.07	-1.02%
Nasdaq	12,925.38	12,888.28	0.32%
Nikkei	27,663.39	27,444.17	0.80%
MICEX	3,277.08	3,289.02	-0.24%
Sensex	46,285.77	47,746.22	-3.05%
SHCOMP	3,483.07	3,473.04	0.29%
S&P Pan Arab	2,247.38	2,183.05	2.95%

Commodities			
Oil-WTI	52.20	48.52	7.58%
Natural Gas	2.56	2.53	1.50%
Gold	1,847.65	1,898.36	-2.67%
Silver	26.99	26.40	2.22%
Copper	7,856.00	7,766.00	1.16%
Soy Beans	1,370.00	1,311.00	4.50%
Corn	547.00	484.00	13.02%
Wheat	663.00	640.50	3.51%

Source: Bloomberg.

Ratings Changes

- There were no significant ratings changes during the month.

Issuance

- In January, Qatar National Bank issued a US$1 billion five-year bond at 95 bps over mid-swaps. This compared with initial guidance of 120 bps over mid-swaps, amid orders of over US$2.5 billion.
- Emirates NBD Bank issued a US$750 million five-year bond at 115 bps over mid-swaps compared with initial guidance of 140 bps over mid-swaps, as orders of over US$2.2 billion were received.
- Dubai Aerospace issued a two-tranche bond deal, made up of a US$500 million four-year and a US$750 million seven-year bond. The issues were at spreads of 230 bps and 275 bps over Treasuries, respectively. This compared with initial guidance for spreads of 260 bps and 310 bps.
- Oman Electricity Transmission Company issued a US$600 million 10-year bond at a yield of 5.8% versus an initial target range of 6.25%–6.375%. The deal attracted orders of over US$4 billion.
- The Oil & Gas Holding Company (nogaholding) raised US$250 million by tapping its outstanding 2024 bond at a yield of 4.386%.
- Bahrain issued US$2 billion in a three-tranche deal, comprised of a US$500 million seven-year bond at 4.25%, a US$1 billion 12-year at 5.25% and a US$500 million 30-year at 6.25%. Yields tightened from initial indications of 4.875%, 5.75% and 6.75%, respectively, as the deal attracted orders of over US$10 billion.
- Oman issued US$3.235 billion across three tranches, including a US$500 million tap of its outstanding 2025 bond. In addition, it issued a US$1.75 billion 10-year bond and a US$1 billion 30-year bond. The tranches were priced at 4.45%, 6.25% and 7.25%, respectively, compared with initial indications of 4.875%, 6.625% and 7.75%. The deal attracted over US$15 billion in orders.
- Saudi Arabia issued US$5 billion across two tranches, comprised of a US$2.75 billion 12-year tranche and a US$2.25 billion 40-year tranche. The first tranche was issued at spread of 130 bps over Treasuries, compared with the initial target of 160 bps, while the second tranche was issued at a yield of 3.45%, versus initial target of 3.75%. The deal attracted over US$21 billion in orders.

- First Abu Dhabi Bank issued a US$500 million five-year Sukuk at mid-swaps plus 90 bps, versus an initial guidance range of 100–105 bps, as orders reached over US$1.4 billion.
- National Commercial Bank issued a debut US$1.25 billion Tier-1 Sukuk at a yield of 3.5%. This compared with an initial yield of 4.125%, amid orders of over US$4.5 billion.

Outlook

We remain optimistic that the potential exists for a cyclical recovery gathering pace during 2021 and that our markets have several relative advantages. In part, this is due to our belief that EM high-yield bonds still offer value and could outperform, having lagged in 2020. We also find this to be the case in the GCC region, with investment-grade spreads now close to their pre-pandemic tights, while high-yield spreads are still above their long-run averages and above previous lows. Additionally, broad investor positioning in EMs is still not stretched and there is the potential for inflows, because despite strong performance seen in GCC bonds over several years, we believe our core markets remain underrepresented in investor portfolios. We believe commodity prices (particularly oil) can rise further, with the GCC region a primary beneficiary through improved fiscal balances. Healthier finances should underpin political, social, and economic reforms, in our view. Perhaps most importantly, the reform momentum remains robust and an attractive aspect of the overall investment thesis for our markets. We do, however, remain watchful for threats to this position and continue to closely analyse tail risks that the markets may be underappreciating.

January proved to be a volatile month, particularly in many equity markets. The month started on a broadly positive footing as the vaccine rollout and economic support in many countries sustained positive sentiment. However, as the month progressed, concerns resurfaced that some countries, including several European markets, could potentially see economic double-dips amid ongoing lockdowns. Additionally, a short squeeze in a handful of US stocks led to worries that several hedge funds would have to sell holdings to cover short positions. Equities fell back into month-end.

Volatile markets are a reminder that recoveries do not happen in a straight line, and we believe that volatility could still hamper progress in certain markets over the coming months. We are cognisant of the risks this presents, but do not view these pockets of market volatility as having an impact in our core markets. We believe that our current positioning is well suited for this backdrop, having reduced risk somewhat towards the end of the year in favour of elevated cash levels. We also have hedges in place against some key tail risks. In addition, it is also worth noting that GCC bonds tend to be resilient in downturns, with relatively low betas and correlations to many risk assets.

Despite current bouts of market volatility, we believe the broad-based economic rebound will continue to develop as the year progresses, as the vaccine rollout helps countries emerge from the COVID-19 pandemic, and this remains the single most impactful development, from our perspective.

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