MENA FIXED INCOME OUTLOOK 2022

THE REGIONAL MARKETS CONTINUE TO DEEPEN

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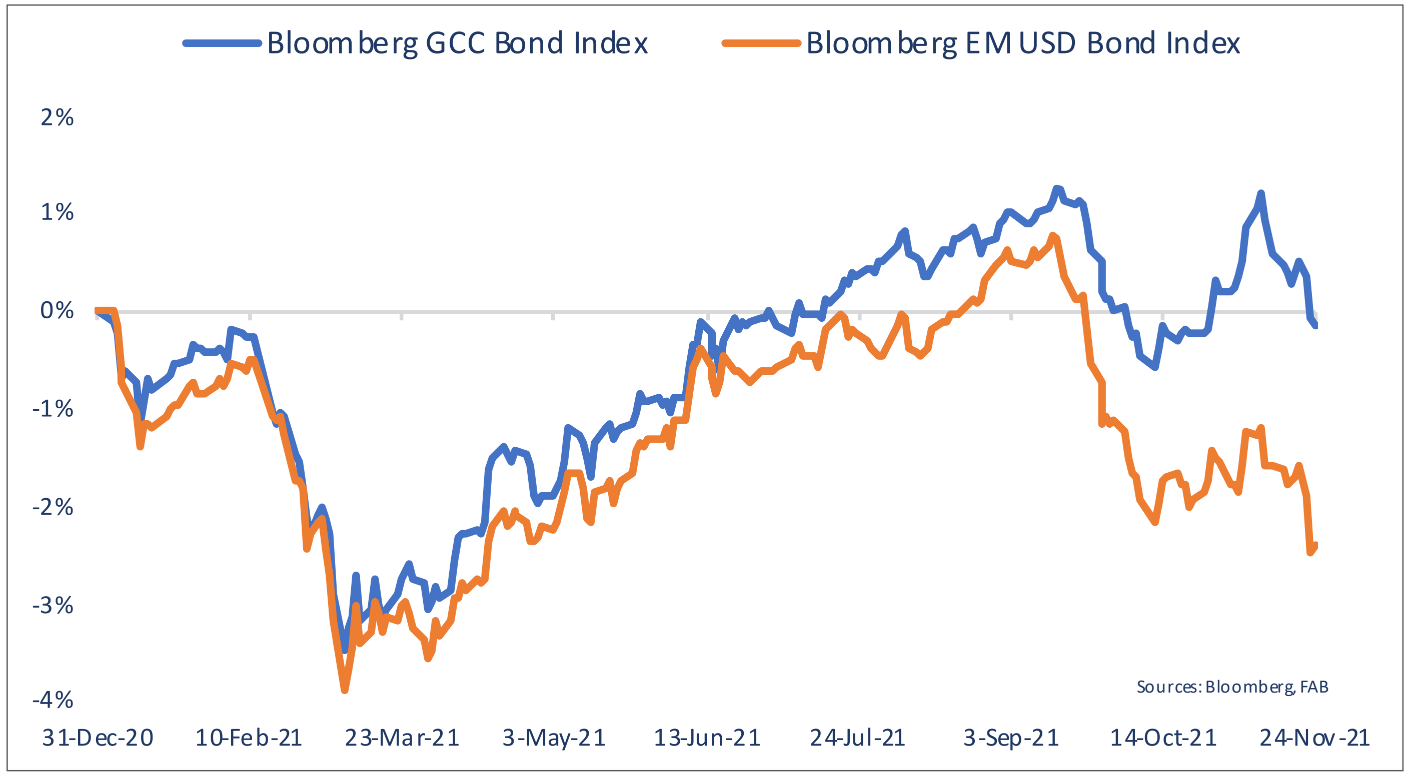
MENA bond markets enter 2022 on the front foot as the region's economic recovery gathers pace. Successful vaccine rollouts have allowed business activity to reopen faster than in other emerging market countries. Increasing oil output and higher prices will continue to contribute to the region's economic growth and fiscal rebalancing, which bodes well for regional fixed income markets as they continue to expand and develop.

The high-yield credits of Oman and Bahrain were the best performers last year, having delivered 6.6% and 1.4% in returns respectively for the year to mid-November. Together with the UAE, the bonds of these two sovereigns saw their yield premiums drop the most among credits in the region. This was understandable for Oman and Bahrain given that high-yield debt tends to outperform during reflationary times, while the performance of Dubai and Abu Dhabi bonds reflected a mixture of recovery and quality.

While the kind of spread compression seen in 2020 and 2021 may be hard to emulate this year, the picture for MENA fixed income is positive. The IMF has raised its regional GDP growth forecast to 4.1% for 2021 and 2022, the latter being a 0.4% percentage point improvement from the previous forecast. Continued stabilisation of the MENA macroeconomic picture should make global money managers more comfortable investing in what was an under-publicised market until just a few years ago.



The relatively higher yields available in MENA compared to other emerging markets remain underappreciated and should encourage more inflows into the region's markets. With favourable and improving rate and credit outlooks coupled with fundamental improvements (diversification away from hydrocarbons, good 'ease of doing business' scores, widened real estate ownership and residence visa developments), there appear to be substantial reasons to invest in MENA fixed income.

UAE

Higher oil revenues and Expo 2020 Dubai should provide a boost to the UAE's economy over the coming months. By the year's end, the authorities had relaxed almost all pandemic measures, allowing economic activity to accelerate at a faster rate than in most MENA countries.

UAE credit conditions should remain positive overall and credit spreads are likely to grind lower during 2022, especially after the Treasuries market selloff in September and October 2021. Investment grade spreads also widened at the time, providing investors with a favourable entry point into UAE credits. The speed of regional economic recovery and improving prospects for the UAE have not gone unnoticed by the world's major rating agencies, which view Abu Dhabi and the UAE as strong AA credits, and this should entice further capital inflows, leading to possible further spread compression.

The UAE Federal Government also recently did its first bond issuance, which is likely to have set the template for the standard debt vehicle for the UAE federation going forward. Accordingly, UAE bonds (Abu Dhabi, Dubai, and Federation) constitute a very attractive proposition in terms of real total returns, especially when compared to similarly-rated sovereigns in European and Western markets.

Kingdom of Saudi Arabia

Like the UAE, we believe the Saudi bond market will continue to benefit from an improving economic and credit background as the country recovers from COVID-19. Increasing revenues from oil production have reduced the government's borrowing needs, which should support bond prices in 2022. As with the UAE, the rating agencies are becoming far more congenial towards Saudi Arabia, having moved the majority of the countries' credits from negative to stable outlooks, which should add further support to the asset class.

Having embarked on an aggressive reform path with its National Transformation Plan, which was first announced in 2016, the country has clearly demonstrated its commitment to fiscal prudence through direct austerity measures and funding initiatives including asset sales and privatisations. Such funding initiatives will facilitate the entry of international investors, and corporate bond issuances could bring in much required capital.

Directed at the private sector, the Shareek program, which encourages capital investment rather than dividend payouts, clearly acknowledges the natural limitation to financing by the sovereign. In addition, with the Public Investment Fund (PIF) ramping up its domestic investment commitments, the government is serious about facilitating growth and the diversification away from hydrocarbons – all of which should be credit-positive. Investment-led growth is more sustainable, and the dominance of Saudi Arabia in regional fixed income markets puts it in a good position to raise foreign capital for certain investments.

Kuwait

The Kuwaiti bond market could remain vulnerable until the country can convince the rating agencies that it has a comprehensive funding strategy in place. As long as Parliament continues to block the government from borrowing after the expiry of the 2017 debt law, the market for Kuwait bonds will remain under a cloud, likely resulting in further negative ratings actions.

Banks, which make up the majority of the credit issuers within Kuwait, however, have performed well through the pandemic and maintained their asset quality. The central bank has continued to appeal to credit investors with its versatile stance, especially regarding the credit quality of the banks under its purview, and this has been positive for overall investor confidence despite the fiscal logjam.

The issuance of bank perpetual notes from Kuwait remains a popular yield play for regional investors, as they have provided a yield pickup of around 200 basis points over the senior unsecured issues of these high credit quality names.

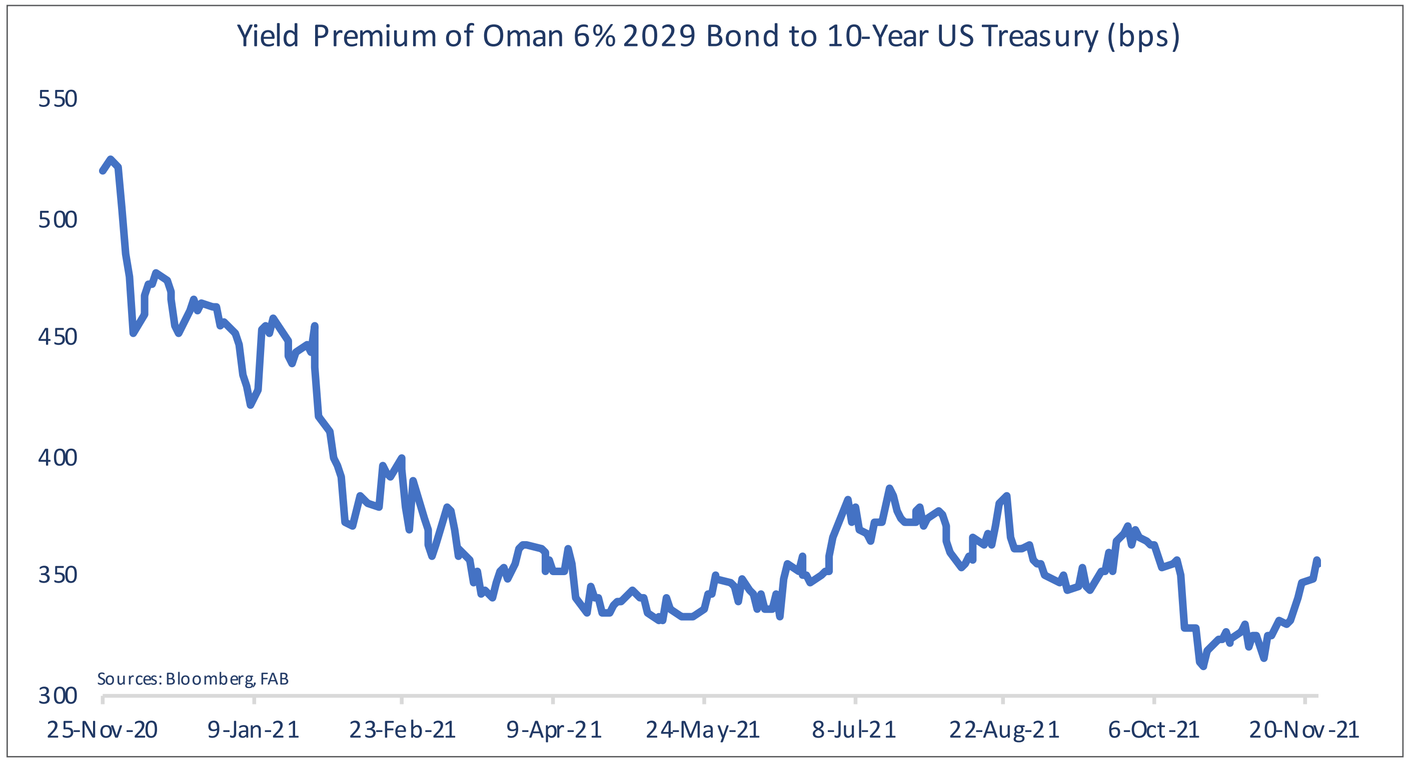
Oman

Oman has enjoyed a renaissance year in terms of performance among regional high-yield credits. Rising crude oil prices have significantly reduced the country's deficit. The government reported a deficit of 1.03 billion Omani Rials in the first nine months of 2021, a 58% drop compared to the same period a year earlier.

After years of reluctance to implement fiscal reforms and austerity measures to curb its twin deficits, Oman finally introduced a value added tax last year and actively cut spending. As a result, rating agencies have moved the outlook on the country's debt to positive.

This helped the yield premium on the country's bonds due in 2032 to tighten by some 80 basis points during the year to the end of November. By November 24th, the premium on these bonds was around 430 basis points, not too far from the spread Oman's 10-year debt paid before the pandemic.

As such, Oman bonds are likely to remain well-supported through 2022 barring any major, unexpected, negative developments in oil markets.



Bahrain

Bahrain has benefited from the recovery in oil prices even if the performance of its bonds has lagged behind those of Oman, the most comparable issuer within the Middle East and North Africa region. The outlook for crude prices remains supportive and so do Bahrain's regional allies, so the country should be able to make progress in balancing its budget by 2024, which should reduce the current yield premiums it is paying in bond markets.

Indeed, the country recently suggested it would consider increasing its value added tax, which would provide more fiscal support to the country.

Given its still high financing needs, Bahrain is likely to remain opportunistic in funding its deficits and refinancing some chunky short-term maturities. The timing of future bond supply will have to be undertaken carefully, however, in what could still be a volatile market environment this year.

Egypt

Economic recovery in Egypt remains slow compared to other major MENA economies. The tourism industry upon which the country relies heavily for fiscal revenue has yet to return to pre-pandemic levels. The country turned to international markets twice during 2021, raising US$6.8 billion in total as it took advantage of lower borrowing costs. This represented significant supply for a country rated in the B category and it added upward pressure to yields.

The IMF expects the country to grow 5.4% in 2022 and 2023, which should help to reduce the country's debt-to-GDP ratio and improve its global credit standing. Therefore, yields could drop this year as the market digests supply and investors continue to hunt for yield.

MENA Bonds and ESG

Despite being viewed by many around the globe as being in primarily a hydrocarbon-based region, Middle East borrowers have been quick to adapt to evolving ESG criteria. MENA governments and corporations are diversifying their economies away from hydrocarbons and improving their reporting on sustainability to maintain future capital inflows.

The UAE and Saudi Arabia recently announced their intentions to be carbon-neutral by 2050 and 2060. While 2050 and 2060 are distant, projects to transition regional economies to 'greener' paths will require substantial financing, much of which should come from bond markets. Indeed, Egypt was one of the first emerging nations to issue a sovereign green bond last year, and such issuance from the region has found healthy investor appetite.

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