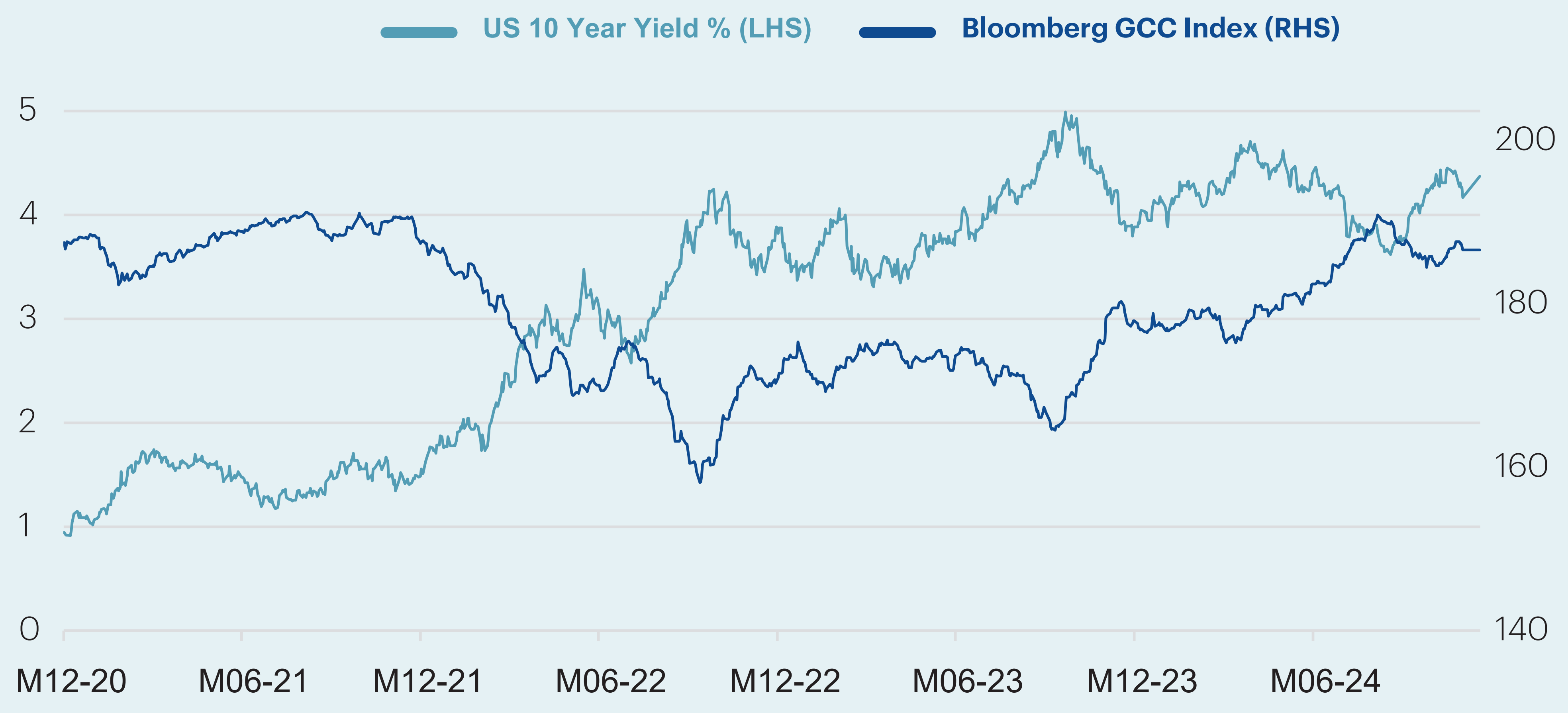
MENA Fixed Income:
Navigating Resilience in a Volatile Landscape

Zehan Salleh – Executive Director, Fixed Income Management

The start of 2024 brought renewed confidence to fixed income investors, fueled by expectations of imminent central bank easing. However, this optimism proved somewhat premature, with the anticipated rate cuts only materialising in the later part of the year. Historically, rate cuts combined with disinflation and moderate economic growth have created a favourable environment for bonds, allowing investors to yield positive returns, even amid fluctuating market conditions.

US 10 Year Yield Vs. Bloomberg GCC Credit + HY Index

Source: Bloomberg



The MENA credit markets, particularly in the high-yield universe, demonstrated remarkable resilience, driven by appealing valuations and strong economic growth. As we head into 2025, these market dynamics appear poised to continue. Geopolitical tensions captured headlines throughout 2024, and these issues will remain central to discussions in early 2025.

The evolving economic fundamentals will play a vital role as we transition from the challenging interest rate environment. As of now, the outlook remains steadfast, upholding predictions that 2024 would be a significant turnaround year for fixed income investments. For instance, the Bloomberg MENA USD Index reflects a remarkable year-to-date return of 5.5% at the point of writing, effectively compensating for losses in 2022.

A Promising Outlook for MENA Credit in 2025

Looking ahead, we project that the fundamentals of regional credit will continue to exhibit strength. The dynamics of higher yields, coupled with a steeper yield curve, are expected to attract renewed investment interest in credit. Fixed income, particularly within regional credits, has regained its appeal—not only due to attractive yields, but also the promising potential for capital appreciation. Investors are stepping into 2025 with a sense of cautious optimism.

Despite lingering market uncertainties, buy-and-hold investors—particularly those focused on yield—found 2024 to be a fruitful period for investment. After many years of deprived yields, 2024 witnessed a peak yield of approximately 6.37% for the Emerging Markets USD Aggregate: MENA Bond Index in April—an impressive contrast to the lows of just over 3% experienced less than four years ago and a prior peak of 7.28% in October 2023. Such a remarkable shift underscores the revitalisation of interest in MENA fixed income as an essential asset class.

The Influence of Global Macroeconomics on Regional Credit Markets

The shifting tides of the global macroeconomic landscape are pivotal in shaping the performance dynamics of regional credits. Towards the end of 2024, market conversations began to pivot from the persistent challenges of inflation to growing apprehension around slowing economic growth. Uncertainty regarding market outlooks for 2025 intensified in the fourth quarter, largely influenced by the policy agenda of the incoming US president. Proposed changes by President-elect Trump—ranging from stricter immigration controls and expansive fiscal initiatives to potential international trade tariffs—introduce significant risks. Such developments could undermine the progress made in managing core inflation and may prompt the US Federal Reserve to reassess its course of monetary easing sooner than previously expected.

Despite these challenges, our outlook for regional credits remains optimistic, underpinned by strong balance sheets and surplus revenues. The defensive characteristics of these credits have captured the interest of investors, particularly as GDP growth rates in the region consistently outstrip global averages. What stands out is not merely the extent of the surplus, but also the quality of GDP growth—fuelled by a robust performance in non-oil sectors—that sets Gulf Cooperation Council (GCC) economies apart from many others within the emerging market (EM) debt universe.

Moreover, the regional banking sector is characterised by prudent management and significant capitalisation, allowing issuers to adopt a balanced yet flexible approach towards debt issuance. This agility became evident throughout 2024 as new issuance activity rebounded, with Saudi Arabia alone accounting for half of the region's primary issuances. Notably, the GCC and Egypt together contributed to 20% of the total Emerging Markets bond issuance.

Moving forward, the interaction between global macroeconomic forces and regional economic resilience will play a crucial role in navigating the intricacies of credit markets. The stability showcased by regional credits not only underscores their resilience, but also reflects the strong economic fundamentals that bolster sustained growth and investor confidence. In an ever-evolving global environment, regional credits have emerged as a compelling investment opportunity, recognised for their financial stability and potential for continued growth.

Unveiling Opportunities in Regional Credits

Regional credits are evolving into a distinct area of opportunity, characterised by an in-depth maturing credit curve that sets the stage for favourable investment conditions. Corporate fundamentals in this segment are expected to remain strong, highlighted by significant credit rating upgrades throughout 2024. A notable example is the Sultanate of Oman, which received an Investment Grade by S&P in September 2024, buoyed by improvements in both its fiscal and current account balances. The Sultanate's successful efforts at deleveraging are expected to encourage further actions from other credit rating agencies, possibly resulting in an upgrade of its sovereign rating to BBB- in the near future.

Meanwhile, Egypt has stepped forward as a standout performer, driven by substantial direct investments from Abu Dhabi and other regional partners into its challenged economy. This inflow of capital has provided much-needed relief amid a protracted two-year crisis surrounding foreign exchange and fiscal balance. Fitch upgraded Egypt's credit rating to B in 2024, while S&P maintains a B- rating, accompanied by a positive outlook. Although Moody's assessment currently places Egypt at Caa1, it too has a positive outlook, and an upgrade to B- is highly anticipated.

Overall, concerns regarding potential downgrades within this subset of the emerging markets universe appear manageable, further enhancing the appeal of regional credits. As such, these assets are poised to continue attracting investors who are seeking stability and growth in an increasingly complex global economic landscape.

Strategic Positioning for the Upcoming Year

Moving into 2025, we have repositioned our duration exposure from an underweight to a neutral position. This adjustment aligns with recent market developments, particularly the notable rise in the 10-year US Treasury yield, which surpassed the 4% mark in the last quarter of 2024. This yield spike represents a timely opportunity for us to increase our investment-grade duration, with a particular emphasis on the 30-year curve to narrow the duration gap relative to benchmark.

Regarding credit allocation, we remain firmly committed to selective opportunities, particularly within the high-yield sector—a stance we advocated in our previous publication. Our investment focus includes, but is not limited to, BBB and BB-rated quasi-sovereigns, regional financial subordinated debt instruments, and a select number of high-yield real estate issuers.

As economic indicators continue to point towards the very low likelihood of a significant slowdown in the United States—albeit acknowledging the associated risks—our approach emphasises the importance of enhanced credit awareness. With credit spreads tightening and nearing historical lows, exercising prudent credit judgment is essential, even as we remain optimistic about the returns expected from this asset class. The robust prospects of regional credits, coupled with strategic positioning, enable us to navigate the complexities of the market effectively as we advance into the new year.

Preparedness for Market Volatility

As we look to the upcoming quarters, we recognise the potential for heightened market volatility driven by global geopolitical events and the uncertainties surrounding economic policies. Acknowledging these challenges, we have strategically positioned ourselves to navigate fluctuations in the market while remaining open to the opportunities that volatility can present through prudent duration positioning and careful sector selection.

At the core of our strategy is the conviction that diversification and maintaining portfolio liquidity are crucial for mitigating risks associated with a volatile market environment. These principles form the foundation of our approach to regional credits, reinforcing our commitment to an actively invested posture within this asset class.

Conclusion

Looking ahead, the resilience and prospective growth of regional credits make them an attractive choice within the broader fixed-income landscape. Our focused strategy on duration, selective credit allocation, and proactive risk awareness positions us to harness both stability and growth opportunities in an ever-evolving investment environment.

By adopting a thoughtful and diversified approach, we are well-equipped to navigate market complexities with confidence and clarity, taking advantage of the potential that lies ahead.