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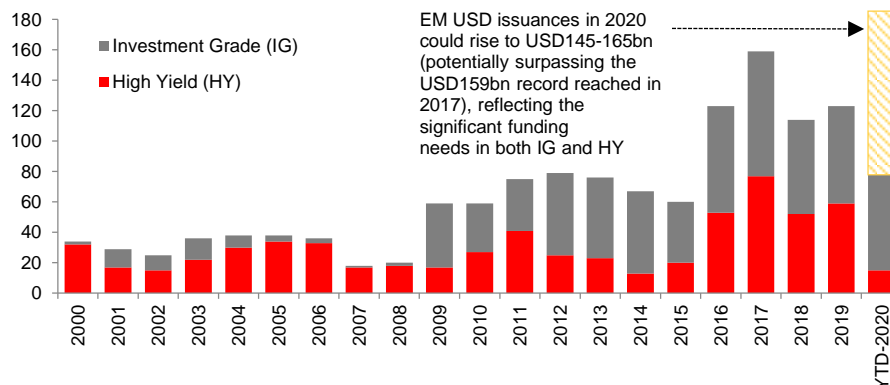
MUFG Bank, Ltd.
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18 May 2020

Examining EM USD sovereign debt issuances – acute deviation between IG and HY

- EM USD sovereign issuance has risen strikingly year-to-date.** Emerging market (EM) sovereigns have issued USD84bn of USD bonds year-to-date, of which USD69bn have come from the investment grade (IG) market, taking IG issuance above its annual average. However, the COVID-19 pandemic has also resulted in significant deviation between EM IG and high yield (HY) issuance, with negligible issuances of USD15bn from HY sovereigns year-to-date. Notwithstanding that the material increase in EM IG echoes developments in issuance from IG corporates in developed markets (DM), it is noteworthy that EM USD issuance do not benefit from any direct policy support, and indeed the majority of primary issuance has come at a discount to the secondary market.
- HY issuance continues to remain more endogenous and correlated to global market risk, whilst IG issuance are more impacted by idiosyncratic factors.** Given HY issuance has historically been more linked to market risks, the level should pick up markedly if risk sentiment recovers in H2 2020. In contrast, IG issuance tends to be less impacted by external factors, and therefore the sizeable issuance year-to-date primarily reflects larger idiosyncratic funding requirements.
- EM USD sovereign issuances could rise to USD145-165bn in 2020 (potentially surpassing the USD159bn record reached in 2017) – meanwhile GCC issuances are expected to total USD54bn this year (largest on record).** Our expectations is for EM USD sovereign issuance to continue being dominated by IG rated sovereigns and with our tracking for a full year total of around ~USD120bn, conditional on risk sentiment remaining flat and constant. However, should risk appetite rise through either a V or a firm U shaped recovery in the global economy in H2 2020, with the market for HY sovereigns – particularly for the MENA region – becomes less challenging, then EM USD issuances could rise to USD145-165bn in 2020, reflecting the significant funding needs in both IG and HY. Specifically in the GCC region, attending to large-scale fiscal financing requirements is expected to lead to a total USD54bn of sovereign USD issuances in 2020, according to our estimates – the largest on record.

EM SOVEREIGN USD ISSUANCES, HY AND IG (USD BN)



Source: Bloomberg, Dealogic, MUFG MENA Research

Examining EM USD sovereign debt issuances – acute deviation between IG and HY

Marked deviation between IG and HY EM sovereign debt issuances

The COVID-19 pandemic has resulted in an acute deviation between emerging market (EM) investment grade (IG) and high yield (HY) sovereign issuances – IG sovereign issuances have been material (USD69bn), whilst issuances from HY sovereigns have been negligible (USD15bn). While the significant rise in EM IG issuances echoes developments in issuance from IG corporates in developed markets (DM), it is important to note that EM USD issuance do not benefit from any direct policy support, and indeed the majority of primary issuance has come at a discount to the secondary market.

EM HY sovereign debt to rise should risk sentiment improve in H2 2020

Historically, EM HY issuances have been more endogenous and correlated to global market risk, and thus would rise considerably should risk sentiment strengthen. In contrast, EM IG issuances tend to be less impacted by external factors, and therefore the sizeable issuance mostly reflects higher funding needs this year. Our examination signals that, in the near term, USD sovereign issuance will likely continue to be dominated by IG rated sovereigns and is tracking for a full year total of around ~USD120bn without a further improvement in risk sentiment. However, if risk sentiment improves, and the market for HY sovereigns becomes less challenging, 2020 EM USD issuance could rise to USD145-165bn (potentially surpassing the USD159bn record reached in 2017), reflecting the considerable funding needs in both IG and HY. Specifically in the GCC region, attending to large-scale fiscal financing requirements is expected to lead to a total USD54bn of sovereign USD issuances in 2020, according to our estimates – the largest on record.

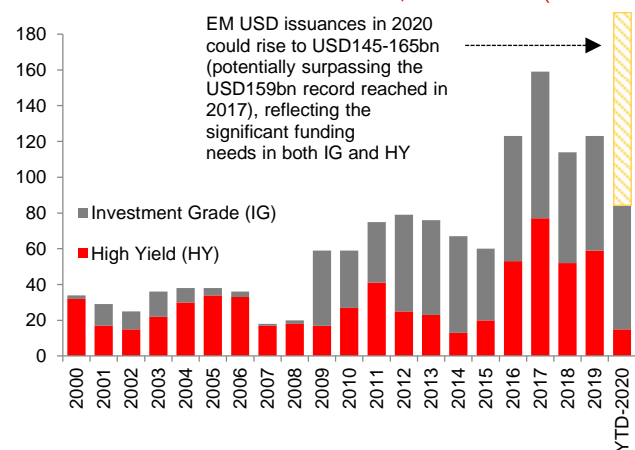
Sensitivity analysis for gauging the impact on EM USD debt issuance

To examine how external factors may impact EM USD debt issuance differently across IG and HY, we estimate the historical sensitivity of monthly IG and HY USD sovereign issuances to three market variables; (i) the VIX, (ii) US 10 year yields and (iii) monthly changes in the EMBI Global Diversified spread. The market variables are applied with a one month lag, and we control for the seasonality in issuance through monthly dummy variables (i.e., issuances tend to be higher at the beginning of the year, given the rebalancing of investor portfolios at the start of each calendar year).

EM HY issuances have historically been more endogenous to global risk

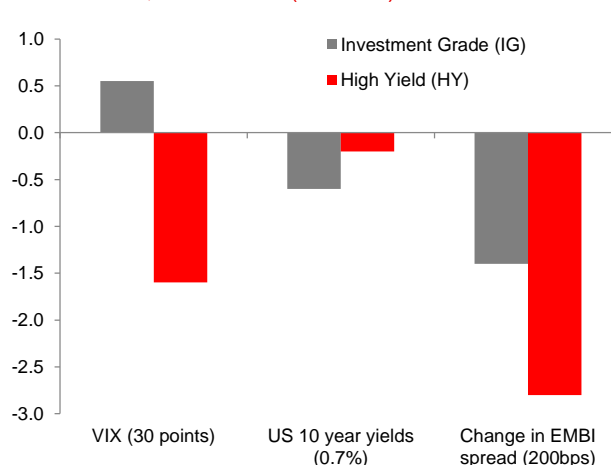
The historical sensitivities of monthly IG and HY USD issuance to the VIX, US 10 year yields and EMBI spreads demonstrate how market variables have normally impacted issuances on the margin. For instance, we find that when the VIX is at 30

EM SOVEREIGN USD ISSUANCES, HY AND IG (USD BN)



Source: Bloomberg, Dealogic, MUFG MENA Research

MARGINAL IMPLICATIONS ON MONTHLY SOVEREIGN ISSUANCES, HY AND IG (USD BN)



Source: Bloomberg, Dealogic, MUFG MENA Research

points, HY sovereign issuance would be ~USD1.5-2.0bn lower than its monthly average, while IG issuance is less sensitive to this variable (i.e., the relationship between the VIX and IG issuance is not statistically significant). We also find that the level of US 10 year yields matters more for IG issuance, and that HY issuance tends to be more sensitive to changes in the EMBI spread, where a ~200bps increase in spreads would lower the average monthly issuance by ~USD3bn.

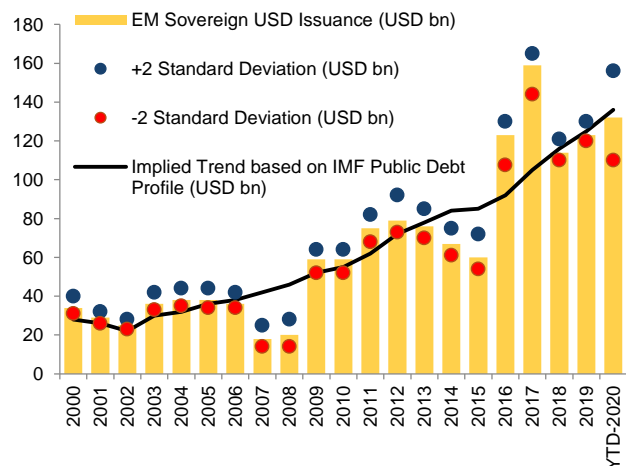
Projections point to a significant increase in issuance from HY sovereigns, notably from the GCC region this year

To assess what issuance might look like if risk sentiment improved significantly, and which regions would be the largest issuers, we examine the projections for public debt. Here, we use the IMF's projections for the EM economies in the EMBI universe, which projects a significant rise in public debt (as a % of GDP) in 2020. In the past, fiscal trajectories have largely mirrored USD issuance, but have usually been below the implied trend in periods where risk sentiment was weak (i.e., 2007-08 and 2015), and above trend when risk sentiment was stronger (i.e., 2016-17). Based on this analysis, projections for rising public debt levels would place EM USD sovereign issuance significantly higher than the USD123bn last year, although this assumes full market access for HY sovereigns. More specifically, for IG, the significant issuance year-to-date is largely consistent with funding needs in 2020, and would point to a slowdown in the pace of issuance going forward, bringing total issuance to ~USD90-100bn from USD69bn currently. In HY, issuances will remain challenging unless the risk backdrop improves, placing year-to-date HY issuance at ~USD25bn, from USD15bn currently. A significant improvement in risk sentiment would put HY issuance significantly higher, at ~USD65bn, of which the majority of issuance would come from the MENA region.

EM USD sovereign issuance will continue to be dominated by IG rated sovereigns but HY will rise should risk sentiment rebound

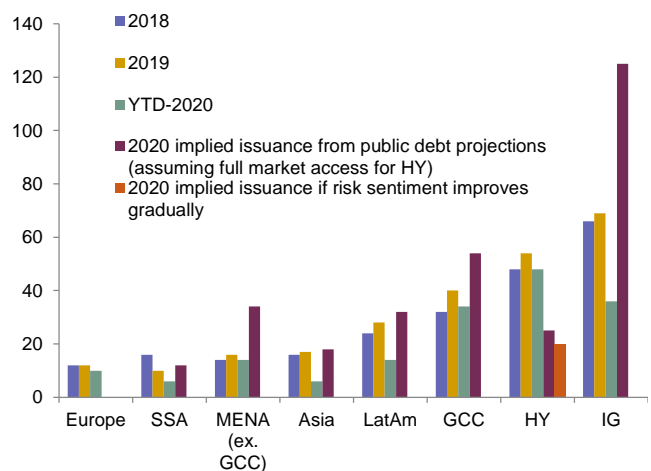
On the whole, our examination signals that EM USD sovereign issuance will continue to be dominated by IG rated sovereigns, and is on track for a full-year total of ~USD120bn without a further improvement in risk appetite. However, if HY access to the international market becomes less challenged, HY issuance will likely come to market in size given large financing needs this year, and could place total issuance for the asset class in the range of USD145-165bn. The extent to which risk sentiment has to improve for HY to regain full access to the international markets is challenging to gauge. It is likely that spreads will have to tighten significantly from current levels, before HY issuance comes back to pre-COVID-19 levels. Nevertheless, some issuers may be able to come to market before, if they are among the group of HY sovereigns with stronger fundamentals. Finally, idiosyncratic risks remain, and could be a hurdle for certain segments of the asset class to return to market in H2 2020.

EM SOVEREIGN USD ISSUANCES WITH IMF PROJECTIONS (USD BN)



Source: Bloomberg, Dealogic, MUFG MENA Research

EM SOVEREIGN USD ISSUANCES BY REGION (USD BN)








Source: Bloomberg, Dealogic, MUFG MENA Research

Economic Weekly Round-up

- **Key data and events in the past week:**
- **Kuwait, Saudi Arabia and UAE** announced fresh voluntary oil production cuts to be implemented in June – curbing production by a further 80k b/d, 1m b/d and 100k b/d, respectively.
- Tamkeen’s Business Continuity Support Programme launched in **Bahrain** last month, with an estimated budget of BHD40m, has so far supported more than 10,000 SMEs.
- **Egypt** received USD2.8bn in emergency financing from the IMF; the country is seeking a further USD5bn from the IMF and USD4bn from other sources.
- Consumer price inflation in **Egypt** increased to 5.9% in April from 5.1% y/y in March, on rising food prices.
- The **Central Bank of Egypt (CBE)** kept main rates unchanged last week.
- **Iraq** will cut its oil output by ~700k b/d, a third less than required under the OPEC+ supply pact (1.1m b/d for May and June).
- **Kuwait’s** balance of payments touched a surplus KWD0.8bn in the fiscal year 2019 from KWD1.1bn the year before.
- **Lebanon** has begun formal negotiations with the IMF, including discussions around the government’s financial recovery plan. A senior finance ministry official revealed that the IMF have requested for clear figures on the losses of the Central Bank. Separately, the Finance Minister stated that the country is ready to float the Lebanese Pound (LBP) only after securing the aid package.
- **Oman** will cut the budgets of government bodies and armed forces by a further 5% this year, according to the Ministry of Finance.
- **Egypt’s** PMI plunged to a historic low of 29.7 in April (March: 44.2), with new orders down to 14.1 (March: 40.2) while purchasing slipped to 21 (March: 39.5). As business expectations remain strong, the employment sub-index inched down to just 46.1 from 47.0 the month before.
- In an interview, **Qatar Airways CEO** disclosed plans to lay off 20% of its workforce, while also confirming that talks were underway to defer aircraft orders for several years. He expects only 50% occupancy when flights resume, with global travel demand unlikely to recover until 2023-24.
- As part of the government’s plan to save SAR100bn amid the COVID-19 pandemic and lower oil prices, **Saudi Arabia** will triple VAT to 15% (from 5% currently) from 1 July and cancel the SAR1,000 cost of living allowance for government employees from 1 June. Separately, the Saudi Gazette reported a cut of close to SAR30bn in the budgets of the Vision Realisation Programs.
- The **UAE** plans to review government structure and size, calling for a “more agile, flexible and speedy government”, as part of its post-COVID-19 strategy.
- Banks and financial institutions have drawn down 77% of the AED50bn worth of funds provided by the **Central Bank of the UAE** under the Targeted Economic Support Scheme (TESS). Under the scheme, banks can defer both interest/profit and principal repayment to extend support to customers impacted by the COVID-19 pandemic.
- **Key focus in the week ahead:**
 1. **Regional** inflation data for April 2020.
 2. In **oil markets**, JODI’s latest monthly report.

Economic Calendar and Forecasts

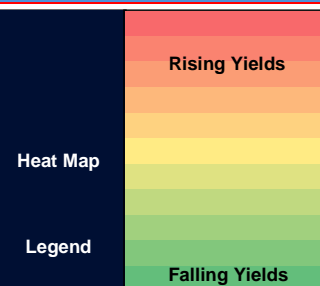
Upcoming Events and Data Releases								
Date		Country	Event	Period	Consensus	MUFG* Forecasts	Actual	Previous
21/05/2020		Turkey	One Week Repo, %	21 May	8.25%	---		8.75%
22/05/2020		Turkey	Capacity Utilisation, %	May 2020	---	---		61.6%
22/05/2020		Saudi Arabia	CPI, % y/y	Apr 2020	---	---		1.5%
22/05/2020		UAE	Dubai CPI, % y/y	Apr 2020	---	---		-1.8%
22/05/2020		UAE	Abu Dhabi CPI, % y/y	Apr 2020	---	---		-2.6%

* MUFG MENA Research
Source: Bloomberg, Refinitiv, MUFG MENA Research

MENA Market Indicators – Tables

Benchmark Bond Yields (% Local Currencies)

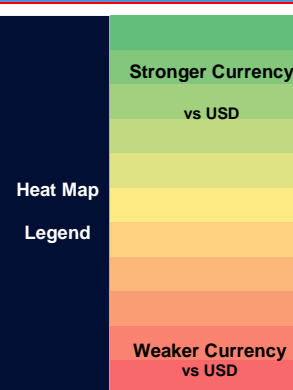
	Maturity	08-May	15-May	Change in Yield (bps)		
				Week	MTD*	YTD*
Advanced Countries						
US	10 yrs	0.68	0.64	-4.0	0.4	-127.5
Germany	10 yrs	-0.54	-0.53	0.6	5.5	-34.6
Italy	10 yrs	1.85	1.86	1.8	10.0	45.1
Japan	10 yrs	-0.00	0.00	0.2	3.1	1.2
MENA Countries						
Bahrain***	3 yrs	5.78	5.31	-46.9	-50.3	231.6
Egypt	5 yrs	13.58	13.65	7.7	-25.3	-0.4
Qatar***	10 yrs	2.90	2.81	-9.6	-15.4	15.6
Saudi Arabia**	10 yrs	2.40	2.39	-1.0	-4.2	-65.4
Abu Dhabi***	7 yrs	2.09	2.07	-2.1	-7.6	-33.9
Dubai***	9 yrs	3.87	3.64	-22.9	-26.1	47.8



Note: * Month to Date and Year to Date; ** 10-year swap rate; *** USD denominated

Exchange Rates vs USD

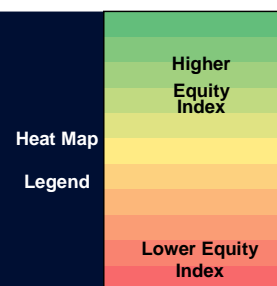
	08-May	15-May	Change (%)		
			Week	MTD	YTD
Advanced Countries					
US Dollar Index	99.734	100.402	0.7	1.4	4.2
Euro Area*	1.084	1.082	-0.2	-1.2	-3.5
Japan	106.650	107.060	-0.4	0.1	1.4
MENA Countries					
Egypt	15.800	15.753	0.3	-0.1	2.0
Kuwait	0.309	0.309	0.0	-0.1	-1.9
UAE 12M Forward	3.683	3.683	0.0	0.0	-0.1
Bahrain 12M Forward	0.379	0.378	0.1	0.1	-0.1
Oman 12M Forward	0.401	0.401	0.1	0.9	-3.2
Qatar 12M Forward	3.659	3.657	0.0	0.0	-0.4
Saudi Arabia 12M Forward	3.773	3.774	0.0	-0.1	-0.6
UAE Spot	3.673	3.673	PEGGED		
Bahrain Spot	0.378	0.378			
Oman Spot	0.385	0.385			
Qatar Spot	3.642	3.642			
Saudi Arabia Spot	3.757	3.758			



Note: * Exchange rate quoted as amount of USD per currency in line with market convention, other exchange rates are amount per USD

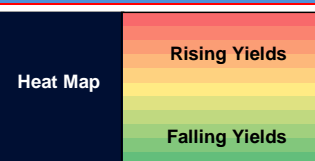
Equity Indices

	08-May	15-May	Change (%)		
			Week	MTD	YTD
Advanced Countries					
US (S&P 500)	2,930	2,864	-2.3	-1.7	-11.4
Europe (STOXX 50)	2,908	2,771	-4.7	-5.4	-26.0
Japan (Nikkei 225)	20,179	20,037	-0.7	-0.8	-15.3
MENA Countries					
Bahrain (BB)	1,298	1,246	-4.0	-4.9	-22.6
Egypt (EGX 30)	10,188	10,357	1.7	-1.9	-25.8
KSA (Tadaw ul)	6,655	6,825	2.5	-4.1	-18.6
Kuwait (KSE)	4,909	4,787	-2.5	-3.8	-23.8
Oman (Muscat 30)	3,473	3,438	-1.0	-2.9	-13.7
Qatar (Doha 20)	8,759	8,699	-0.7	-0.7	-16.6
UAE (Abu Dhabi)	4,022	4,065	1.1	-3.9	-19.9
UAE (Dubai)	1,919	1,912	-0.4	-5.7	-30.9



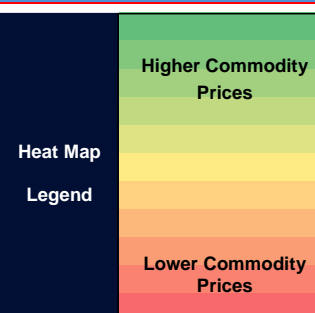
5 Year USD CDS Spreads

	01-May	08-May	Change in Yield (bps)		
			Week	MTD*	YTD*
MENA Countries					
Bahrain	469.63	460.10	-9.5	-27.7	284.1
Kuwait	103.04	95.96	-7.1	-9.1	59.3
Qatar	115.09	107.59	-7.5	-17.2	70.9
Saudi Arabia	162.95	154.75	-8.2	-14.6	97.8
UAE (Abu Dhabi)	115.22	107.51	-7.7	-17.3	71.4
UAE (Dubai)	275.66	265.76	-9.9	-28.8	174.8



Commodity Prices*

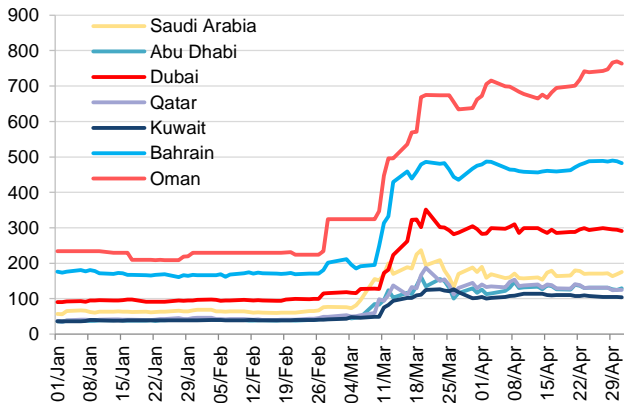
	08-May	15-May	Change (%)		
			Week	MTD	YTD
Energy					
Brent	31.0	32.5	4.9	28.6	-50.8
WTI	24.7	29.4	19.0	56.2	-51.8
LNG	1,402.3	1,372.0	-2.2	-2.5	41.6
Precious Metals					
Gold	1,703	1,744	2.4	3.4	14.9
Silver	15.5	16.6	7.3	11.0	-7.0
Industrial					
Copper	#N/A N/A	5,182	#VALUE!	-0.1	-16.1
Steel	479	474	-1.0	1.3	-19.4
Aluminum	#N/A N/A	1,462	#VALUE!	-2.2	-19.2
Wheat	530	500	-5.5	-5.6	-10.5



Note: * Spot prices or nearest expiring future

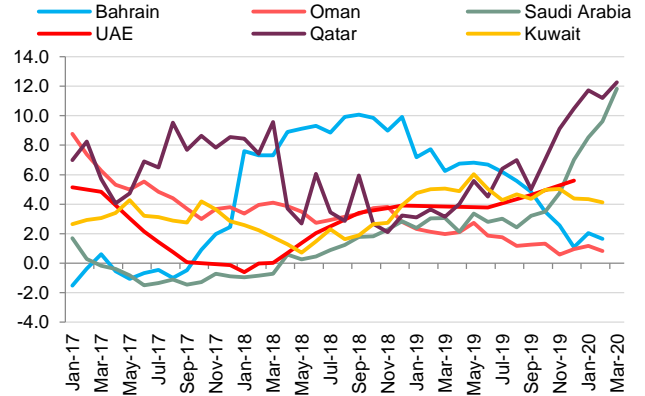
MENA Market Indicators – Charts

CHART 1. GCC 5 YEAR CDS SPREADS (BASIS POINTS)



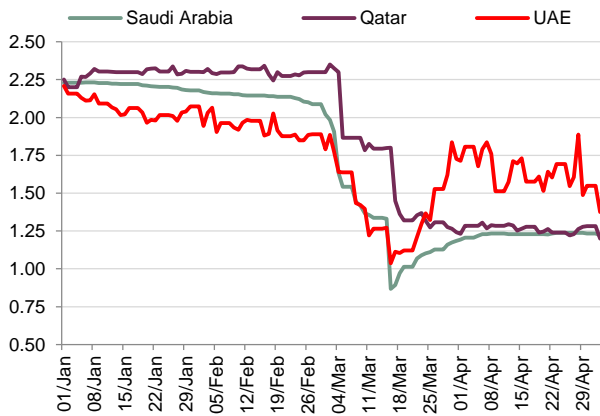
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 2. GCC PRIVATE SECTOR CREDIT GROWTH (% Y/Y)



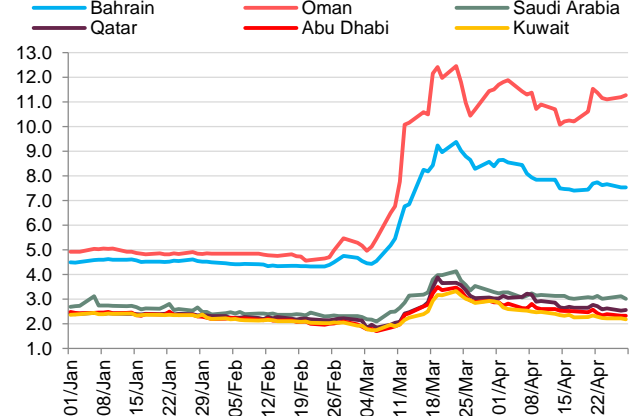
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 3. CORE GCC 3 MONTH INTERBANK RATES (%)



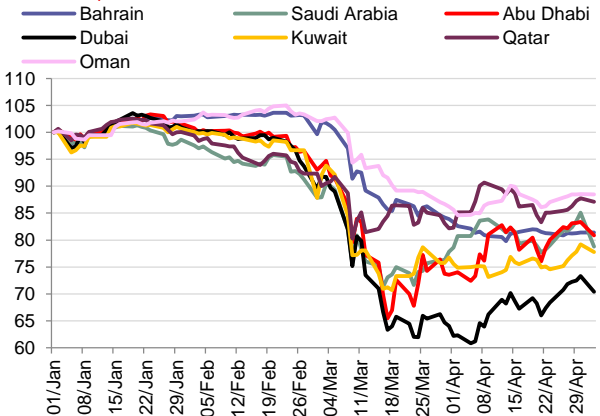
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 4. GCC 10 YEAR SOVEREIGN BOND YIELDS (%)



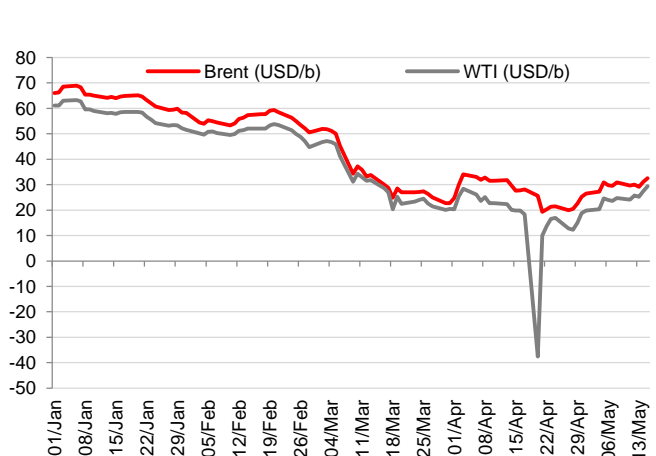
Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 5. GCC EQUITY MARKETS (REBASED JANUARY 2017 = 100)



Source: Bloomberg, CEIC Database, MUFG MENA Research

CHART 6. BRENT AND WTI CRUDE PRICES (USD/B)



Source: Bloomberg, CEIC Database, MUFG MENA Research

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