AL MASAH CAPITAL LIMITED

الماسة كابيتال ليمتد

MENA Bond Market: Untapped Potential and its Impact on Your Portfolio

- **What is the significance of bond market in the MENA region?**
- **Which types of bond issues are more prevalent?**
- **What are the key structural and cyclical growth drivers of bond market in the MENA economies?**
- **What proportion bonds constitute in the investor portfolios of the MENA region?**
- **Why is secondary bond market development needed?**
- **What factors hinder the growth of bond market?**
- **Which bonds performed better during the economic crisis period?**
- **What were the impacts of Dubai and European debt crisis on the MENA bond markets?**

Executive Summary

MENA capital markets are still in their embryonic stage compared to other world markets. This is evident from the fact that they accounted for just 1.1% of the total global capital market size in 2008. Historically, bank lending has always dominated the capital market activity in the MENA region. However, the crash in oil prices during the 1980's and low oil prices in 1990's forced regional governments to diversify their economies into other non-oil sectors and reduce dependency on oil. This led to increased demand for expansion capital. Furthermore, as bank lending mostly catered to short-term funding needs of corporations, other modes of financing such as equity and debt also emerged as preferable financing avenues. Lately, other new financing routes – SWAP agreements, Exchange Traded Funds (ETFs) and Real Estate Investment Trusts (REITs) – that are already popular in the western world have started surfacing in the MENA capital markets.

Higher financing requirements led to increased activity in the MENA equity markets, which boosted their share in total (global) capital market activity during 2006–2007. However, due to the global economic recession, oil prices tumbled and equity markets plunged across the MENA. This led to subdued IPO activity in the region. Hence, bonds increased in popularity as means of long-term financing in the MENA region's corporate sector.

The GCC bond market expanded at a CAGR of 30% during 2003–09 to reach US$72.8 billion. While higher infrastructure development and diversification initiatives have resulted in an increased need for long-term financing, the volatility in regional stock markets has forced issuers and investors to look for alternative avenues of fundraising and investment, respectively. However, the MENA debt market still accounted for just 6.4% of total capital market activity in the MENA region in 2008. Hence, there is a large scope for the development of the region's bond market(s).

Contrary to western bond markets that only cover conventional bonds, the MENA bond market also includes Shariah-compliant sukuks (Islamic bonds). Nevertheless, sukuks have a smaller share compared to conventional bonds. Bond issuers raised the largest amount through conventional bonds in the GCC region during 2009. There were 93 conventional bond issuances amounting US$61.5 billion in 2009 (representing 84.5% of total bonds issued). On the other hand, 33 sukuks worth US$11.3 billion were issued in the same year.

Recent rise in the demand for Islamic investment products in the MENA region (mainly UAE) as well as other East Asian economies (primarily Malaysia) has fuelled the growth of sukuk issuances globally. The value of global sukuks issued increased to US$19.15 billion in 2009; the MENA region accounted for 40% of this value. Going forward, the MENA sukuk market is expected to register robust growth as evident from its strong pipeline (52 sukuks worth US$14.83 billion are planned for 2010 and 2011).

In the past five years, the share of bonds in the investor portfolio (bonds, bank deposits and market capitalization of listed stocks) increased from 1.7% in 2005 to 5.1% in 2009 in the GCC region. This reflects increasing investor optimism towards bond market compared to other capital market components. Infact, bond markets performed better compared to equity markets in the region during the crisis period. This is evident from the returns offered by regional bond indices compared to equity market indices. While the Middle East Conventional Bond Total Return Index (MEBI) declined just 2.0% during July 2008–July 2009, other regional indices such as Dubai Financial Market, Kuwait Stock Exchange and Tadawul plummeted 67.2%, 47.7% and 40.2%, respectively.

However, there is a significant need to develop the secondary bond market in the MENA region, which is characterized by low trading activity on regional exchanges such as Tadawul. Moreover, most of the investments in the region's bond market have been done by institutional investors so far. Hence, the bond market has been highly inaccessible to regional retail investors as there are not many secondary trading platforms.

Bond issues by the way of Euro Medium Term Notes (EMTN) program have become a popular source of financing in the MENA region since 2005, especially in those emirates and countries that have lesser proportion of oil revenues compared to other regional peers. EMTN program has aided many MENA countries to tap the European bond markets. Also, it is an important means for leveraging the bond market in the region.

Although the MENA bond markets are witnessing growth, some of the regional companies defaulted on their sukuk repayments at maturity in the last 18 months, the major one being Nakheel Development's massive US$3,520 million sukuk default in November 2009 that shook the global debt markets and led to high CDS spreads in the region. Furthermore, during Q1 2010, the European debt crisis (mainly Greece) added to the worries of the global debt markets, including MENA.

Nevertheless, the situation has improved now as there have been many large issuances in the MENA bond markets in H1 2010. The recent issuances have provided stability to bond markets, thereby raising optimism over its future performance. We believe that the recovery in oil prices and high amount of economic activity in the form of massive investments in non-oil sectors would aid the future growth of debt markets in the region.

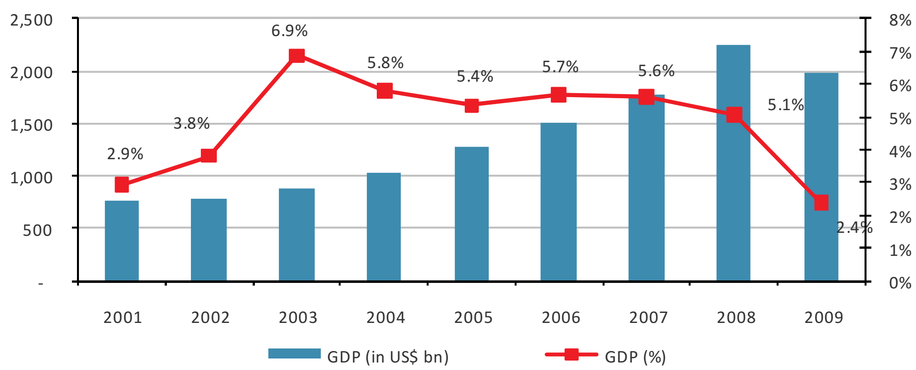
MENA Bond Market

Overview of MENA Capital Market

Egypt's EGX is the oldest exchange in the MENA region

MENA capital market primarily covers three traditional modes of financing - Banks, Equity and Debt markets. Capital markets in the region were informal during as late as 1980s; however, they have grown rapidly in the past decade on account of higher financing needs. Among countries in the MENA region, Egypt and Kuwait witnessed early capital market development. Egyptian Exchange (EGX) is the oldest stock exchange in the MENA region. The exchange was formerly known as Cairo and Alexandria Stock Exchange (CASE); it comprised of two exchanges – Cairo and Alexandria exchanges. While the Alexandria Stock Exchange was officially established in 1883, the Cairo Exchange was formed in 1903. Later in March 2009, CASE changed its name to EGX. Kuwait's stock market – the Kuwait Stock Exchange (KSE) – is also among the oldest stock exchanges in the MENA region. KSE was established in 1962, and has gained huge reputation for playing a key role in development of capital markets in the country. Saudi Arabia's Tadawul Exchange was established in 2007; however, it has become one of the largest stock markets in the region promoting huge capital market activities. Growth of the corporate sector in MENA in the past two decades has led to a rise in real GDP growth in the region. The corporate sector has expanded driven by the diversification policies of governments, especially in the GCC region. However, corporates required long-term funding for massive expansion, and this was possible through the capital market route. This supported the growth of capital markets in the region.

Exhibit 1: **GDP growth rate trend (2001–2009) – MENA region**



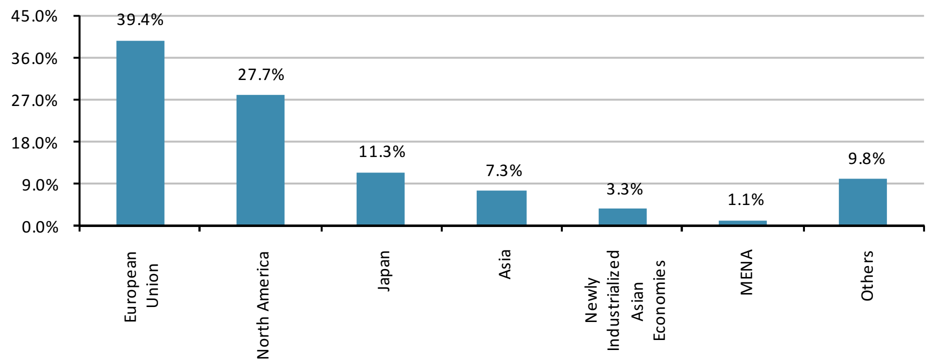
Source: IMF

Composition of MENA Capital Market

MENA capital market accounts for a meager 1.1% of the global capital market size in 2008

MENA capital market is relatively underdeveloped compared to its other western counterparts. According to IMF's Global Financial Stability Report released in April 2010, MENA capital market accounted for just 1.1% of the global capital market size in 2008. There are various modes of financing in capital markets - Banks, IPO/Equity and Debt markets.

Exhibit 2: **Global capital market activity (region-wise) - 2008**

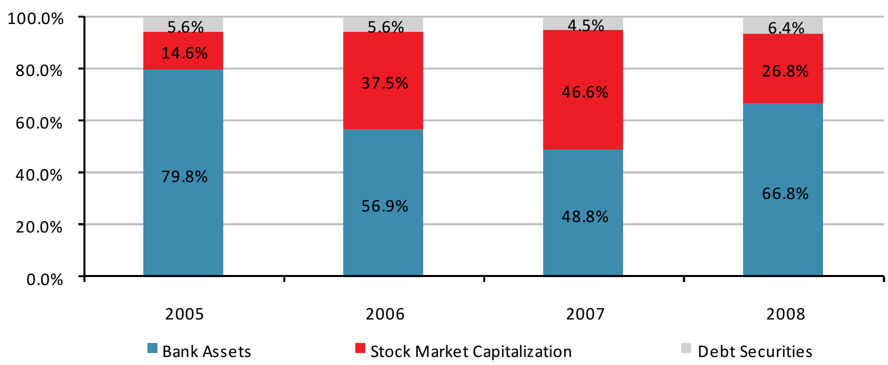


Source: IMF Global Financial Stability Report, April 2010

Historically, bank lending has been a popular source of capital in the MENA region

Bank lending has always been the predominant source of capital in the MENA region. However, the share of bank lending in the capital market has reduced since past five years. Bank lending accounted for 66.8% (US$1,628.2 billion) of the total capital in MENA region (US$2,435.9 billion) in 2008 compared to the 79.8% (US$869 billion out of US$1,088.8 billion) share in 2005. As the need for long term capital increased following the expansion of the corporate sector, other modes of financing such as equity and debt also gained pace. Equity markets have emerged as an attractive source of financing in the MENA region over the last decade. The setting up of regional exchanges such as Egypt's EGX, Kuwait's KSE and Saudi Arabia's Tadawul eradicated broker trading and lured many corporates that were interested in raising capital through the equity route. The share of stock market capitalization in the total capital market size in the MENA region grew from 14.6% in 2005 to 26.8% in 2008. However, volatility in equity markets during 2008–2009 forced many corporates and other governmental institutions to search for other additional options of long-term financing. Hence, the bond market emerged as a viable alternative. Although MENA debt market accounted for just 6.4% of the total capital market activity in the region in 2008, it has depicted a fair growth from 5.6% in 2005.

Exhibit 3: **MENA capital market trend (2005-2008)**



Source: IMF Global Financial Stability Report, April 2010

SWAP agreements and ETFs are also gaining pace in MENA capital markets

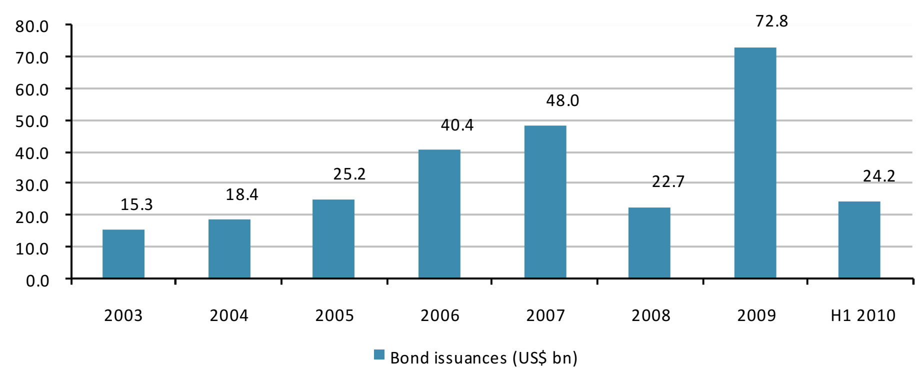
As the regional economy continues to expand and evolve, many other alternative sources of finances are also being explored in the MENA capital markets. These include SWAP agreements, Exchange Traded Funds (ETFs), Real Estate Investment Trusts (REITs) and Special Purpose Vehicles (SPVs). On August 18, 2008, Saudi Arabia's stock market regulator Capital Market Authority (CMA) allowed foreign investors to execute equity swap agreements in respect of listed Saudi shares. The policy is designed to facilitate a foreign investment route other than nominee arrangements and investment funds. In terms of ETFs, Dubai has taken the lead among MENA region. Shariah-compliant gold ETF was launched on NASDAQ Dubai in March 2009, World Gold Council being the main sponsor for the ETF. Dubai Gold Securities is expected to establish a benchmark for regional investors looking for innovative solutions to invest in commodities within the framework of Islamic finance. Such new modes of investments are expected to be instrumental in the growth of MENA capital markets.

MENA debt market at an early stage of development

Large investments in infrastructure, petro-chemicals and real estate highlighted the need for debt financing

Historically, during the pre-industrialization phase, financing needs of large corporates (mostly quasi-government institutions) in the MENA region was catered by their respective government and its affiliate agencies. Other businesses in the region were family-owned, and financing demand of such business groups was either catered by internal accruals or by banks. However, the crash in oil prices during the 1980's and low oil prices in 1990's forced regional governments to diversify their economies into other non-oil sectors and reduce their dependency on oil. Many regional governments such as Saudi Arabia, Qatar and Kuwait started developing industrial cities to build a stable industrial base. By the year 2000, expansion in the region's non-hydrocarbon sectors gained pace. Massive investments in the development of infrastructure, petrochemicals and real estate highlighted the need for additional avenues of raising finances.

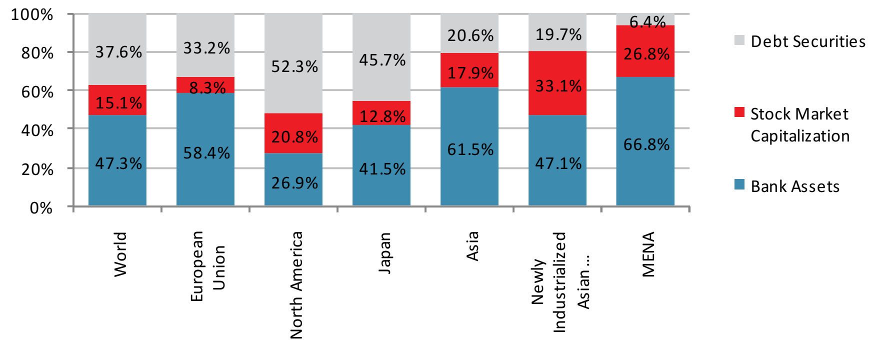
Exhibit 4: **Total bond issuances in the GCC region (US$ bn)**



Source: Markaz, Al Masah Capital Research

As traditional financing modes such as bank lending mostly catered to the short-term financing needs of large corporates, debt market emerged as an additional option for raising long-term finance. The bond issuances in the GCC region have increased from US$15.3 billion in 2003 to US$72.8 billion in 2009. Also, the size of MENA debt securities stood at US$155.3 billion in 2008; out of this, US$90.0 billion included private debt securities. Despite a rapid growth witnessed in the past decade, MENA debt market is still in the nascent stage when compared to its western counterparts. MENA debt market accounted for just 6.4% of the total capital market activity in the region in 2008.

Exhibit 5: **Region-wise global capital market activity - 2008**



Source: IMF Global Financial Stability Report, April 2010

Types of bond issues in the MENA region

The MENA bond market is primarily classified into two types:

- Conventional bonds
- Sukuks – Shariah-compliant bonds

MENA bond market has conventional as well as Islamic bonds (sukuks)

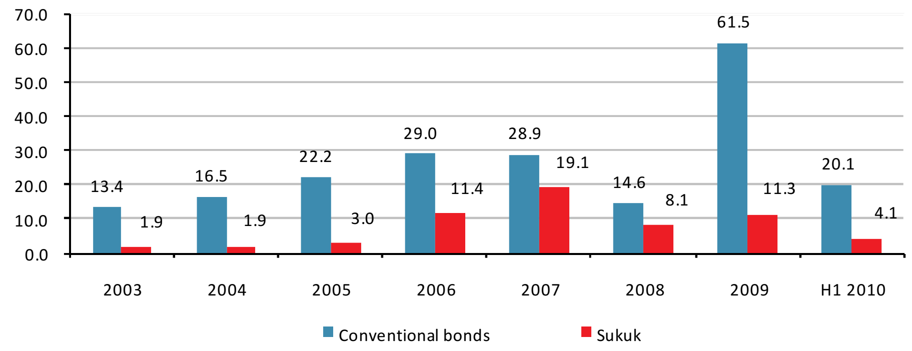
Unlike the western debt markets that include just conventional bonds or fixed income securities, the MENA region has bonds as well as sukuks (Islamic bonds). Sukuks have evolved as the preferred route of securing funds by many corporates as well as governments in the MENA debt market compared to conventional bonds. The main reason for the sukuk's popularity in the MENA region is its compliance with the Shariah principles.

Bond market growth

GCC bond market grew at a CAGR of 30% during 2003–09 reaching US$72.8 billion

The GCC bond market increased at a CAGR of 30% during 2003–09 reaching US$72.8 billion, according to a report by Kuwait Financial Centre - Markaz. As a matter of fact, in 2009, the bond market recorded a remarkable 221% growth rate. Volatility in the equity markets due to the global economic crisis lured the corporates towards the bond market. Following its historical trend since 2003, issuers raised the largest amount through conventional bonds in the GCC region with 93 issues worth US$61.5 billion in 2009. Hence, conventional bonds represented 84.5% of the total bonds issued in the GCC region in last year. On the other hand, there were 33 sukuk issuances in 2009, amounting to US$11.3 billion.

Exhibit 6: **Sukuk and conventional bond issuances in the GCC region (US$ bn)**



Source: Markaz

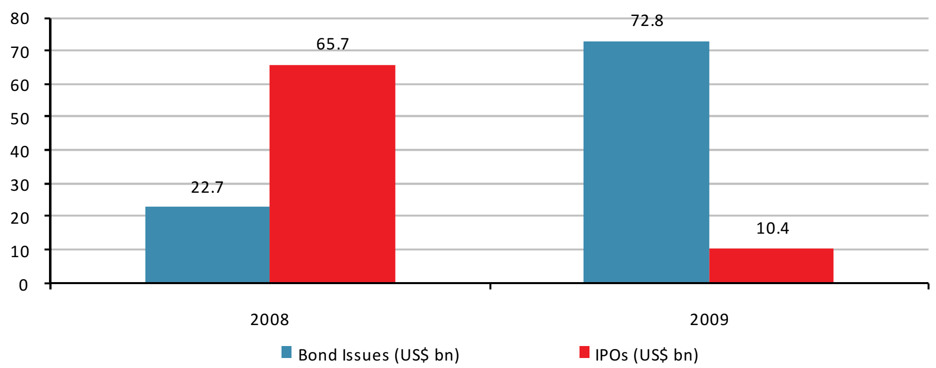
Comparison between the Amount Raised from IPOs and Bonds from 2008 to date

MENA bond market saw more intense activity during 2009 relative to equity market

The year 2008 was a golden year for the MENA equity markets as 161 IPOs (including FPOs) amounting to US$70.6 billion took place on various exchanges. In the GCC region as well, US$65.7 billion was raised through 89 IPOs in 2008. The favorable economic environment driven by high oil prices (in the first half of 2008) and heightened economic activity led the equity markets higher. Moreover, expansion initiatives by the corporate sector also aided the growth in IPO activity in the MENA region. Contrary to this, bond market activity in the region was subdued in 2008 as the equity market environment was conducive for IPOs, especially in the first half of the year.

Nevertheless, the scenario reversed during 2009, when the economic crisis hit the global economy. Consequently, MENA equity markets tumbled and hence, IPO activity dwindled. During 2009, US$12.8 billion worth of IPOs were issued in the MENA region (of which the GCC region contributed US$10.4 billion). The unfavorable equity market environment forced several corporations to look upon bond markets as a viable alternative for raising long term capital. Conventional bonds worth US$61.5 billion and sukuks totaling US$11.3 billion were issued in the GCC region during 2009.

Exhibit 7: **Bond Vs IPO issues in GCC**



Source: Markaz, Thomson ONE Banker

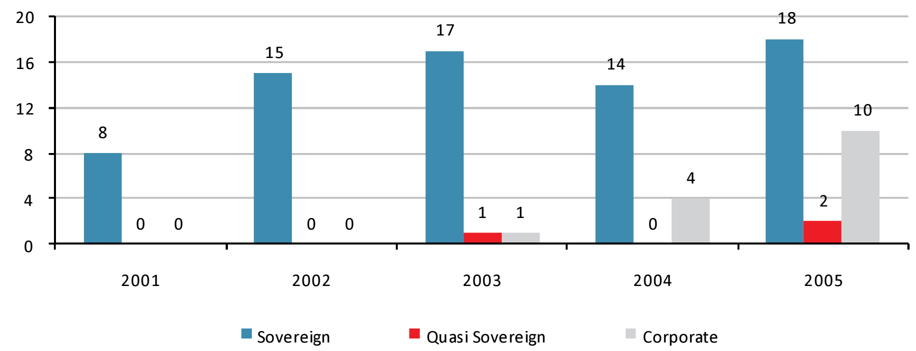
Sukuk Trends

Sukuk issuances dominated by sovereigns until 2005

Sovereign sukuk were prominent in MENA region until 2005

Most sukuks issued until 2005 were sovereign issues. Governments in the region looked upon sukuks as a means of funding expenditure, when oil prices remained low. However, an upsurge in oil prices thereafter contributed to government revenues, and the scenario began to change.

Exhibit 8: **Number of sukuk issuance (by type) in MENA 2001-2005**



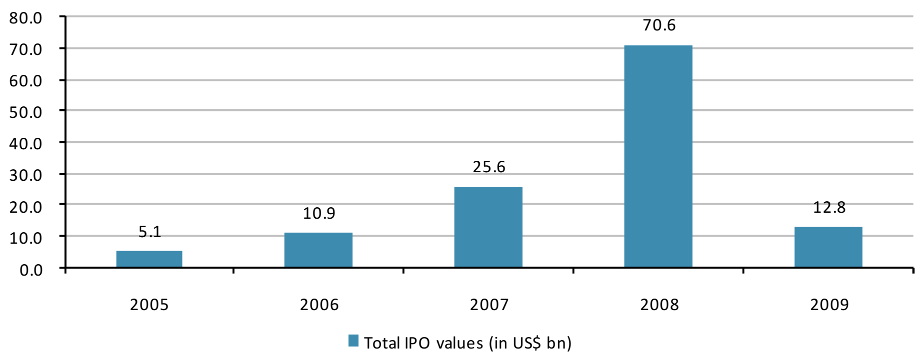
Source: Zawya

After 2005, the corporate sector participation picked-up

Diversification initiatives of MENA governments led to the rise in corporate bond issues after 2005

Focus of governments in the MENA region towards diversification led to a rise in many non-oil sector projects, including those in petrochemical, real estate and retail. As bank lending was the most popular means at that the time, many banks in the region came under pressure to fulfill the requirements of the increasing number of corporates interested in taking loans. Bank lending in MENA's largest economy–Saudi Arabia–grew just 10% to SAR497.07 billion in 2006 compared to 34% and 36% growth in 2004 and 2005, respectively. Moreover, equity markets also faced a high level of volatility during the recessionary period of 2009. Also, not every corporate had access to the IPO route for funding its long-term capital requirements.

Exhibit 9: **Total IPO values (in US$ bn) in MENA for past 5 years**

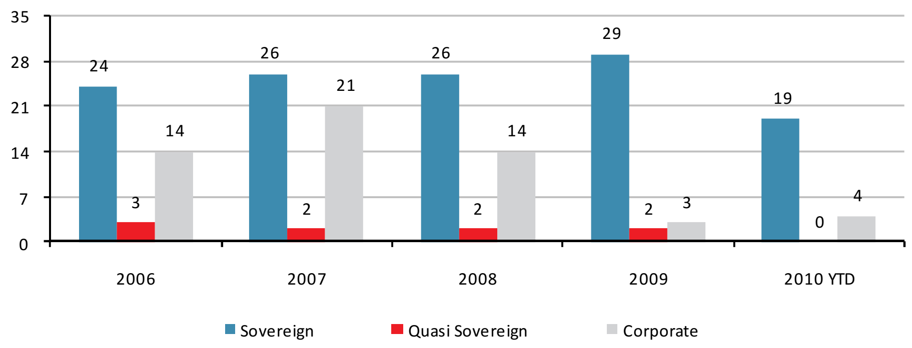


Source: Thomson One Banker, Al Masah Research

Equity markets downturn in 2009 reduced IPO activity in the MENA region

The MENA region witnessed a fall in number as well as IPOs (including FPOs) raised in Q1 2009. There were 29 IPOs in Q1 2009 amounting to US$3.7 billion compared to the 44 IPOs worth US$31.4 billion in Q4 2008 and 29 IPOs totaling US$8.9 billion in Q1 2008. Even for 2009 as a whole, IPOs issued in MENA region declined to US$12.8 billion from US$70.6 billion in 2008. This created a need for other financing options among the large corporates and financial institutions that required capital for executing projects. At this point, sukuks emerged as the popular means of long-term financing for large corporates, as they appealed to the investors interested in placing their money in Islamic investment products.

Exhibit 10: **Number of Sukuk issuance in MENA 2006-2010 YTD**



Source: Zawya

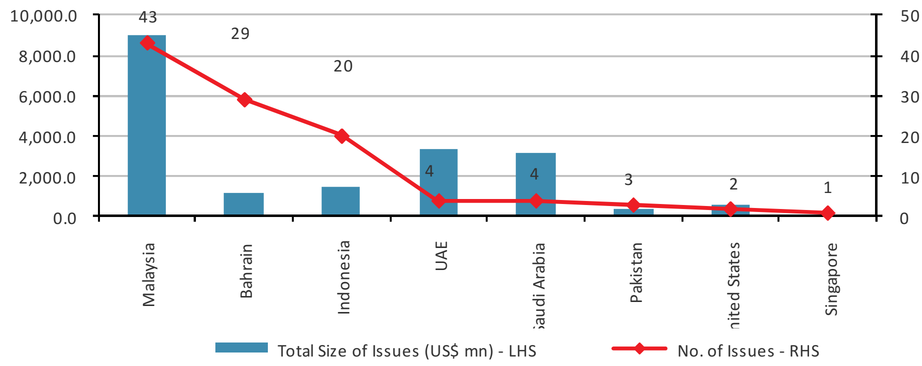
The sukuk market's performance in the MENA region during 2009 and 2010 YTD

UAE was the largest sukuk market in the MENA region in 2009 with US$ 3.33 billion of sukuks issuance

Recent rise in demand for Islamic investment products in the MENA region (mainly UAE) as well as other East Asian economies (primarily Malaysia) has fuelled the growth of sukuk issuances globally. During 2009, equity markets suffered drastically and bank lending was tightened due to a tough economic environment. This resulted in the inclination of large corporates towards alternate methods of financing—among which sukuk became the most popular and convenient way of financing. Consequently, the value of global sukuks issued increased to US$19.15 billion in 2009.

With the issuance of 43 sukuks (out of the total 106 globally) worth US$9.01 billion in 2009, Malaysia topped the worldwide list. Countries in the MENA region accounted for 40% of the total value of sukuks issued in 2009. The UAE was the largest sukuk market in value terms. The country issued four sukuks worth US$3.33 billion, followed by Saudi Arabia (four sukuks amounting US$3.11 billion) and Bahrain (29 sukuks totaling US$1.19 billion).

Exhibit 11: **Size of global sukuks issuance - 2009**

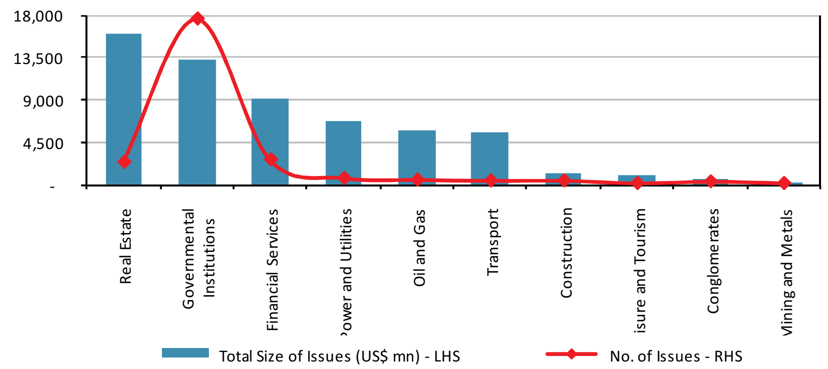


Source: Zawya

Apart from government institutions, financial services and real estate sectors topped the sukuk market in the MENA region

During the period between December 31, 1996 and September 27, 2010, there were 276 sukuks issued in the MENA region totaling US$59.36 billion. Although, government institutions are the largest issuers of sukuks in the MENA market, other sectors witnessing growth in the sukuk market are financial services and real estate. The major reason for this is the government's diversification policy which encourages the growth of these sectors. Out of the total sukuks issued until September 27, 2010, 196 issues (totaling US$13.20 billion) were from government institutions followed by the financials services and real estate sectors with 29 (US$9.08 billion) and 26 (US$15.99 billion) issues, respectively.

Exhibit 12: **Sukuk issuance (in US$ bn) in MENA region by sector (total to date)**



Source: Zawya

Healthy sukuk pipeline

Fifty two sukuks worth US$ 14.83 billion are planned from the MENA region for 2010 & 2011

As far as the global sukuk pipeline is concerned, about 149 sukuks amounting US$32.89 billion are planned until 2011. Among these, 52 sukuks worth US$14.83 billion would be from the MENA region.

The largest planned sukuk for 2010 is the Iran Sukuk from Iran with an issue size of US$3.18 billion. Other large sukuk issues in 2010 are from the UAE, Qatar and Saudi Arabia. The UAE sukuk issuance includes those of Emaar Sukuk Limited with an issue size of US$2 billion and Dubai Global Sukuk with an issue size of US$1 billion. Qatar's Doha Bank Sukuk, which is also coming up in 2010, is worth US$1 billion. Saudi Arabia is coming with three sukuk issues in 2010 – Islamic Development Bank MTN Sukuk amounting to US$1 billion, Jubail Refining and Petrochemical Company Sukuk totaling US$997.6 million, and Al Oula Sukuk worth US$800 million.

Exhibit 13: **Major Sukuk Pipeline in the MENA region**

Sukuk Name	Country	Issue Size (US$ mn)	Subscription Date
Iran Sukuk	Iran	3,181.5	2010
Emaar Sukuk Limited	UAE	2,000.0	2010
Doha Bank Sukuk	Qatar	1,000.0	NA
Dubai Global Sukuk	UAE	1,000.0	2010
Islamic Development Bank MTN Sukuk (Tranche 2)	Saudi Arabia	1,000.0	2010
Jubail Refining and Petrochemical Company Sukuk	Saudi Arabia	997.6	2010
Al Oula Sukuk	Saudi Arabia	800.0	2010
QIB Sukuk	Qatar	750.0	2010
Bahrain Islamic Bank Sukuk	Bahrain	663.8	NA
ADIB Tier 1 Sukuk	UAE	545.0	2010
Dubai Bank Sukuk (Tranche 1)	UAE	500.0	2010
The Investment Dar Sukuk 2	Kuwait	500.0	2010
Lebanon Sukuk	Lebanon	331.7 - 464.3	2011
Dar Al Dhabi Sukuk	Kuwait	346.6	2010
Al Salaam Bank - Bahrain Sukuk	Bahrain	227.6	2010
Gulf Finance House Sukuk	Kuwait	200.0	2010
Al Baraka Sukuk	Bahrain	200.0	2010
Al Aqeeq Sukuk	Saudi Arabia	186.7	2010
Ekttitab Sukuk	Kuwait	175.0	2010
First Investment Company Sukuk	Kuwait	156.0	2010
Al Safwa Group Sukuk	Kuwait	150.0	2010
Ahmed Salem Bugshan Sukuk	Saudi Arabia	100.0	2010
ADCB Malaysian Sukuk	UAE	95.5	2010
Sakana Sukuk	Bahrain	50.0	2010

Source: Zawya

Major growth drivers of MENA Debt market

Both structural and cyclical factors are driving the growth of the MENA bond market

Bond markets in the MENA region have witnessed significant growth in the past decade. Several structural and cyclical factors have led to increased bond market activities in the region. While higher infrastructure development and diversification initiatives have resulted in increased need for long-term financing, the volatility in regional stock markets has forced both issuers and investors to look for alternative avenues of fund raising and investment, respectively. While cyclical drivers have been influencing growth in the debt market over the past few years, particularly in the wake of global economic crisis, there are several structural drivers in place that could drive the MENA debt markets, going forward.

1. Structural growth drivers

a) Investment in infrastructure development

The MENA region in general and the GCC countries in particular have been investing heavily in infrastructure development. The trend is expected to continue - According to BMI, GCC countries would invest over US$119.6 billion in infrastructure projects over the next 10 years; out of this, rail projects would account for more than 90%. The recently approved US$385 billion ninth five-year plan of Saudi Arabia focuses on the development of infrastructure in segments such as education, healthcare and water desalination. Major initiatives include: (i) setting up of 25 new technology colleges, 28 higher technical institutes, and 50 industrial training institutes; (ii) building 17 new hospitals and 750 primary healthcare centers; and (iii) doubling the present capacity of desalination plants from 1.05 billion cubic meters to 2.07 billion cubic meters. Kuwait's US$129 billion four-year economic development plan (2013/2014) announced early this year comprises several large infrastructure projects, including a new business hub named Silk City (estimated to cost US$77 billion), a container harbor, a 25-kilometre causeway, and a railway and metro system. The Qatari government as well as other government-owned companies plan to spend around US$100 billion in the next four years on projects such as roads, sewage treatment, water treatment, ports and airports. UAE too is investing in nuclear power and railways to restore economic growth in 2010 and 2011. According to industry estimates, construction projects worth US$726 billion are expected to be underway in the MENA region in 2010.

Massive infrastructure investments has forced large corporates to adopt bond market route for financing

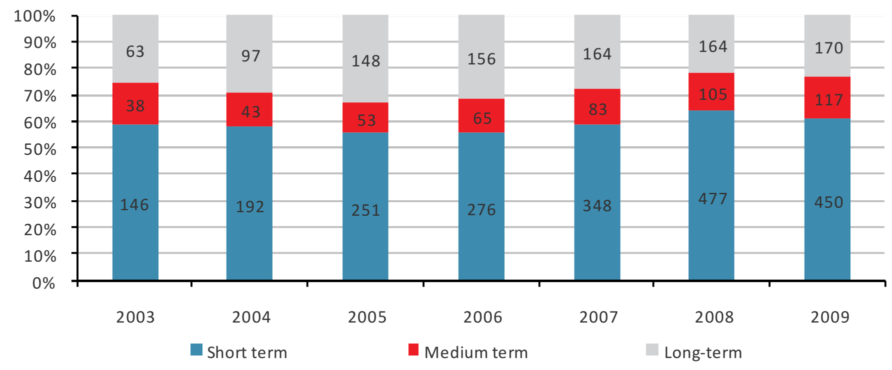
In addition, a large number projects that were put on hold are being restarted across the MENA region. Nomura, in its August 2009 report (MENA Infrastructure and Construction), mentioned that projects amounting about US$500–600 billion were on hold in the MENA region (quoted as Proleads, MEED estimates). After 2009, as the global economic climate strengthened many of these stalled projects have started reviving, which would need debt financing.

b) Short-term nature of bank credit

Bank lending mostly caters to short-term needs of corporate sector

Historically, bank lending has been the predominant source for fulfilling the financing needs of corporates in the MENA region. However, a majority of bank lending in the MENA region is done for short-term only. This is clearly evident from the bank lending trends in Saudi Arabia – one of the largest nations in the MENA region. Short-term bank lending in the Kingdom dominated overall bank lending during 2003–2009; it accounted for 61% of the total lending portfolio in 2009. Hence, there was a need for another financing route that could suffice to the long-term funding needs of institutions.

Exhibit 14: **Bank lending pattern in Saudi Arabia**



Source: SAMA

c) Broader development of Islamic finance, especially the sukuk market in compliance with Shariah principles

Sukuk's adherence towards Shariah principle has attracted many corporates towards it

Islamic finance has evolved as a major sector in the MENA region since the past few years. Several banks are focusing on Islamic products to attract customers. Besides this, as Sukuks comply with Shariah principles, they are gaining popularity among investors across Muslim-populated countries globally, including the MENA region. Apart from Shariah compliance, Sukuks have to be backed by physical collateral. Consequently, they are perceived to be less risky financial instruments relative to conventional bonds. These factors have increased the popularity of Sukuks. Issuances in GCC grew from US$1.9 billion in 2003 to US$19.1 billion in 2007, recording a CAGR of 78.1% during 2003–07. Though Sukuk issuances in the GCC region declined to US$8.1 billion in 2008, they have revived in 2009 with issuances of worth US$11.3 billion. The Sukuk market in MENA region is likely to pickup in 2010 as evident from the current pipeline of US$13.2 billion.

d) Local government's initiatives to develop bond market

A few countries such as UAE (Dubai in particular) and Bahrain in the MENA region are emerging as regional financial centers. Having a well-developed bond market is critical for the overall development of a financial center, and as such these countries are keen on developing an active bond market. The NASDAQ Dubai (started in 2005), jointly owned by DFM and NASDAQ OMX, has a bond trading platform.

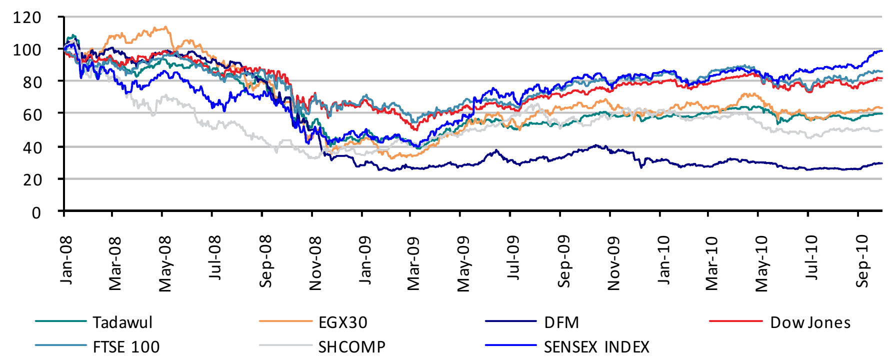
2. Cyclical growth drivers

a) Volatility in equity markets

Volatility in equity markets during 2008-2009 led to the growth of bond market

Global economic slowdown during 2008-2009 led to a decline in equity markets worldwide. MENA equity markets also could not escape from the wrath of recessionary pressures. Most corporates that were earlier planning to raise capital through the equity markets route had to defer their plans. In fact, cancellation of IPOs continued in early 2010. This is evident from the cancellation of Saudi Arabia-based Al Tayyar Travel Group's IPO amounting to US$320m in February 2010 as its book building process was not able to generate enough demand. Saudi Arabia's Tadawul Exchange and Egypt's EGX, the major stock markets in the MENA region, fell 39.5 and 34.1% respectively in 2008. Hence, large corporates and institutions had to look for an alternative option to fund their expansion plans. The drastic fall in equity markets eroded the wealth of investors as well. Market cap of all stocks traded on the Tadawul declined to US$246.3 billion in 2008 from US$515.1 billion in 2007. Thus, the bond market emerged as an alternative for raising funds among these corporates and as an alternative (also less risky) investment avenue for investors.

Exhibit 15: **Performance of major global equity markets (2008 – 2010 YTD)**



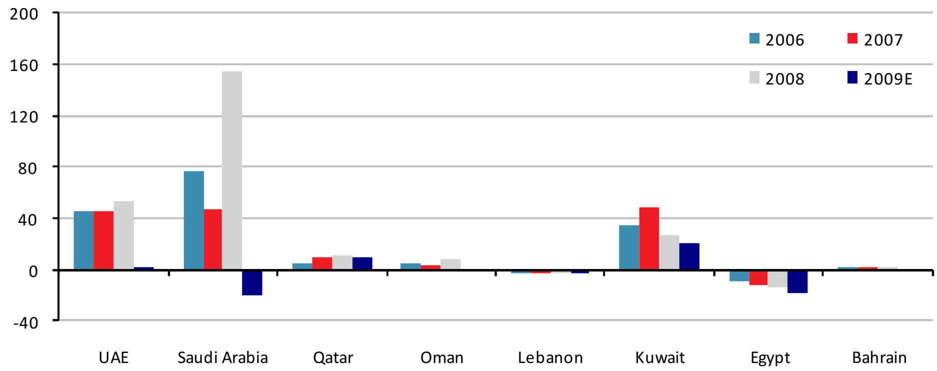
Source: Bloomberg

b) Declining government surpluses

Fall in government surpluses as a result of declining oil prices forced many regional governments to look at bond market route

Oil revenue, which is the major income source for most MENA region economies, declined during 2009 on account of a fall in oil prices. Lower demand due to weak global macro environment was the primary reason for the decline in oil prices. Consequently, huge fiscal surpluses enjoyed by most of the MENA governments plummeted during 2009. Moreover, higher spending during the downturn led to a decline in government finances, thus forcing large corporates and institutions to look out for other options to raise money to cater their expenditures. Hence, debt market emerged as a viable option among other capital market financing modes.

Exhibit 16: **Fiscal balance (US$ bn) trend of major MENA economies**



Source: IIF

Tight lending policy of the banks during the crisis period attracted corporates towards bond markets

e) Scarcity of bank credit

The economic turmoil forced the banking sector to tighten its lending policy. Total bank lending in Saudi Arabia declined to SAR736.9 billion in 2009 compared to SAR744.8 billion in 2008. Although the situation has improved to some extent in Q2 2010 (as reflected by the rise in bank lending to SAR746.9 billion), bank lending still remains tight. Hence, in our view, bond markets would continue to grow in the future.

Tenor of bond issuances in the MENA region

Most of the bonds issued in MENA have 1-5 year tenor

During 2005–2010, the typical tenor of conventional bond issuances in the MENA region was one to five years. However, a few of the bonds have tenor up to 31 years. The 31 year bond worth QAR1 billion was issued by the Qatari government on November 24, 2009 with a coupon rate of 6.4% and maturity date set at January 20, 2040. For the period 2005–2010, bonds with a 30-year maturity period have also been issued in the MENA region. These include Abu Dhabi National Energy Company (TAQA)'s bond issuance worth US$1.5 billion on October 27, 2006 with a coupon rate of 6.5%; the Morocco government's MAD2.0 billion bond issued on December 04, 2006 with a coupon rate of 4.5%; DP World's US$1.75 billion bond issuance on July 02, 2007 with a coupon rate of 6.85%; and the Egypt government's US$0.5 billion bond issued on 29 April, 2010 with a coupon rate of 6.875%.

Will a 100-year bond be viable in the region?

The MENA, particularly the GCC, has been witnessing a large number of infrastructure projects over the last 10 years. As these projects are long term in nature, the infrastrucure developers need similar financing. However, as discussed earlier, bond markets in the MENA region are still underdeveloped. Unlike developed markets, a bond with a 100-year maturity period has not been issued till date in the MENA markets. However, it has been issued in other global bond markets, typically by sovereign authorites, power companies and railroad operators. In July 1993, Walt Disney Company and Coca-Cola Company both issued a 100-year bond worth US$300 milion and US$150 million, respectively. Most recently on October 06, 2010, the Mexican government issued a US$1 billion bond with a 100-year maturity. Corporations such as US-based railroad operator Norfolk Southern Corp. also announced in August 2010 its plan to sell US$100 million worth of 100-year maturity bonds. Furthermore, Netherlands-based Rabobank has issued USD$350 million worth of bonds with the exceptional term to maturity of 100 years on September 15, 2010.

Growing need for long-term financing could lengthen the tenor of the bonds in MENA region

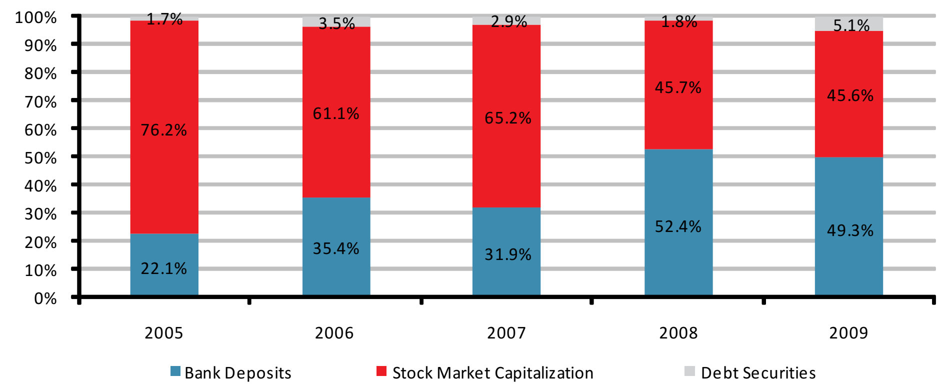
The main objective behind issuing a 100-year bond by corporations is to benefit from market demand. Hence, there must be a large group of instituional investors ready to buy such bonds. Also, these institutional investors use 100-year bonds to lengthen the duration of their bond portfolios in order to fulfill certain duration-based goals. Purchase of a 100-year bond clearly indicates the investor's postive sentiment on the long-term performance of the company. As MENA bond markets are less developed compared to other gobal bond markets, investor confidence for a 100-year bond seems low, and hence we believe such a bond is not viable for the region at least in the short-to-medium term. Nevertheless, seeking the huge growth in MENA bond markets and the need of long-term financing in the region, a 100-year bond may be a possibilty in the long term.

Attractiveness of bonds as an investment option

Proportion of bank deposits to the total capital market size in the GCC region has increased from 22.1% in 2005 to 49.3% in 2009

Bank deposits, equity securities, bonds, gold and real estate are the most popular investment avenues among the Middle East investors. In terms of regional investors' preference, bank deposits seem to be the most preferred investment avenue. This is clearly evident from its huge share among the total capital market size. The ratio of bank deposits among the total capital market size in the GCC region has increased from 22.1% in 2005 to 49.3% in 2009. On the other hand, the proportion of stock market capitalization has reduced from 76.2% in 2005 to 45.6% in 2009 due to the volatility in the stock markets that has made investors cautious.

Exhibit 17: **Share of bonds in investment portfolio of investors – GCC**

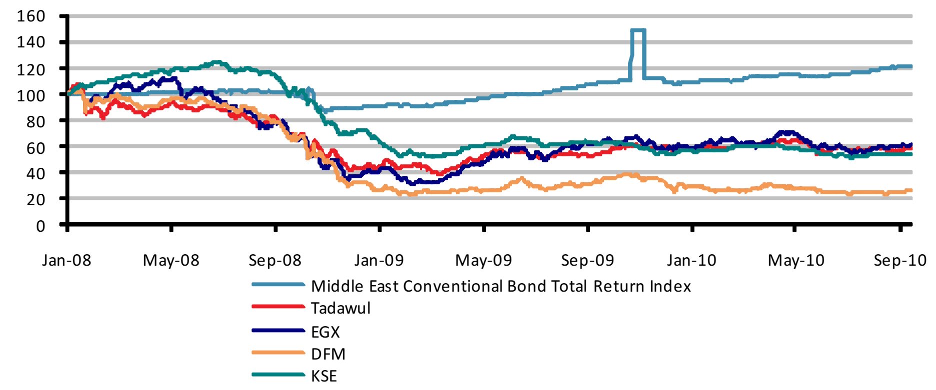


Source: Central Banks, World Bank, Markaz

GCC bond markets grew 30.4% during 2005–09, reaching US$72.8 billion in 2009

During the same period, the proportion of bonds outstanding to total investments (bank deposits, investments in stocks-market capitalization and investments in bonds) in the GCC region also rose from 1.7% in 2005 to 5.1% in 2009. In terms of CAGR, GCC bond market grew 30.4% during 2005–09, totaling US$72.8 billion in 2009. Though the bonds have gained popularity among regional investors (as reflected in the growth in the debt securities outstanding), the overall investment in them is still miniscule. While the small size of investments in bonds itself indicates its growth potential, the 2008–09 stock market crash has raised the importance of having bonds in the portfolio of investors. Bonds performed much better during the crisis and as such an inclination to have some portion of the wealth invested in bonds would increase going forward, in our view.

Exhibit 18: **Regional equity indices vs Bond index return (rebased)**



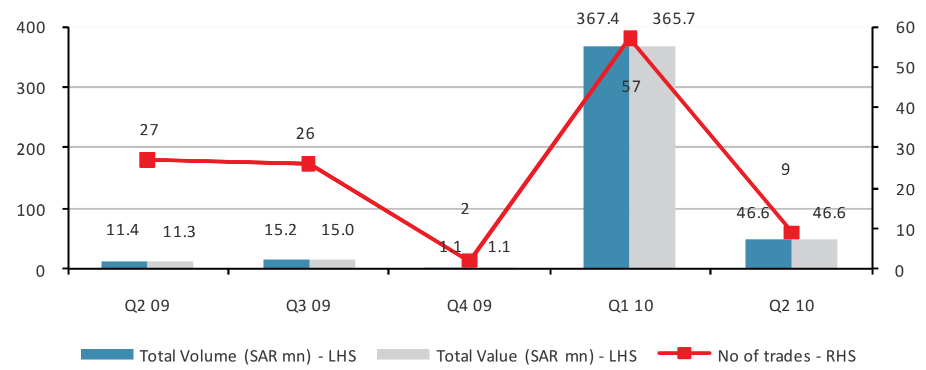
Source: Bloomberg, HSBC DIFX

Need for the developed secondary bond market in the MENA region

Sukuk and bond trading at Tadawul witnessed a downfall in the number of trades to just 9 trades in Q2 2010 from 57 in Q1 2010

The MENA region's secondary debt market is still developing as reflected from its small presence, that too only some of the countries in the region – Saudi Arabia and the UAE. Lack of trading activity clearly reflected from the sukuk and bond trading trend on Tadawul has restricted the growth of the secondary debt market in the MENA region. Although the primary sukuk and bond market seems to have revived in Q2 2010, the secondary market activity on Saudi Arabia's Tadawul exchange went down after seeing growth in Q1 2010. The secondary market trading witnessed a downfall in the number of trades to just 9 trades in Q2 2010 from 57 in Q1 2010. The total value of sukuk and bond traded on Tadawul in Q2 2010 also declined to SAR46.6 million from SAR365.7 million in Q1 2010. The low trading activity on Tadawul is ascribed to the debt crisis in the European region (primarily in Greece) that was at its peak in Q2 2010 and acted as a contagion for other global bond markets, including MENA.

Exhibit 19: **Trend in Sukuk & Bond trading on Tadawul**



Source: Tadawul

Progress towards an efficient secondary bond trading platform could lead to better price discovery of fixed income instruments

Several factors together make it a strong case for developing the secondary bond market in the MENA region. Mostly institutional investors have been able to invest in the region's bond issuances so far. The bond market has been highly inaccessible to regional retail investors as there are not many secondary trading platforms and even in the exchanges where bonds are traded, the volumes are very low.

The development of an efficient secondary bond trading platform could lead to better price discovery of fixed income instruments. In addition, the mix of bonds with different maturity profiles would assist in creating a yield curve, which the region lacks currently.

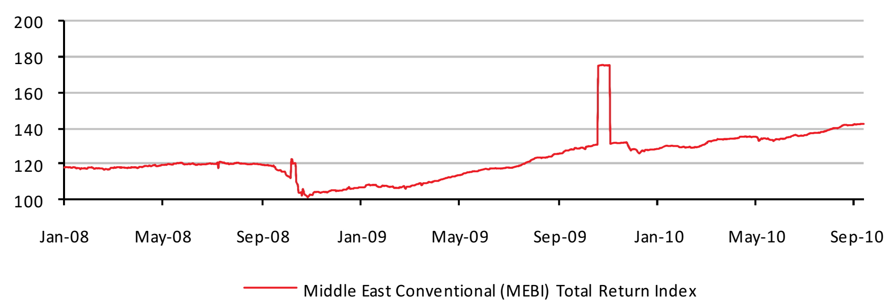
Return Analysis – Conventional Vs Islamic Bonds

In 2008 conventional bonds took the lead over sukuks. While the Dow Jones Citi Global Sukuk Total Return Index (an indicator of the sukuk market performance) increased 81.3%, the Middle East Conventional Bond Index (an indicator of the conventional bond performance) grew 90.7% in 2008.

During 2008, conventional bond gave better returns compared to sukuks

However, in 2009, when the effects of the global economic crisis were felt most sukuks performed better than the conventional bonds. In the same year, the Middle East Conventional Bond Total Return Index rose 120.1% contrary to the 127.1% increase in the Dow Jones Citi Global Sukuk Total Return Index.

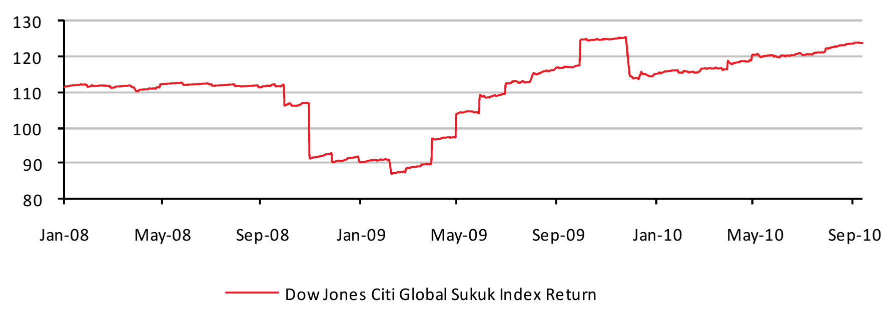
Exhibit 20: **Middle East Conventional Bond Total Return Index**



Source: HSBC DIFX

Exhibit 21: **Dow Jones Citi Global Sukuk Total Return Index**

During the crisis period of 2009, sukuk index gave better returns than conventional bond index



Source: Bloomberg

Regional Euro Medium Term Notes (EMTN) program

EMTN program has aided many MENA countries to tap the European markets

EMTN program helps regional companies to tap the European markets for raising debt funds. Large corporates and government institutions from the region, mainly those from Dubai (UAE), Lebanon and Egypt, have raised finances through the EMTN route since 2005. Although corporates (mostly banks) have been raising money through the EMTN route since a long time in Dubai, government issues gained prominence from 2008. On March 12, 2008, the Lebanese government, through EMTN route, issued a bond amounting US$875 million with a coupon rate of 9.125% and maturity period of five years. In April 2008, the Government of Dubai established an EMTN program of AED15 billion. Following that, the government issued an AED4 billion floating rate note at a coupon of three-month EIBOR plus 0.5%. Furthermore, it issued another fixed-rate note of AED2.5 billion at 4.25%. Both these bond issues have five-year tenure and would mature on April 23, 2013.

Dubai is leading in terms of bonds issued through EMTN route in the MENA region

On February 22, 2009, the Dubai government issued bonds worth US$10 billion with a coupon rate of 4.0% and maturity period of five years. On March 19, 2009, the Lebanese government issued US$1.5 billion EMTN with a coupon rate of 9% and maturity period of eight years. Further in October 2009, the Dubai government's EMTN program was updated, and hence the aggregate nominal value of the issuable notes increased to US$4 billion. Apart from the two government bond issues, there were seven other issues by Abu Dhabi Commercial Bank and Emirates Bank in the UAE. During 2009, out of the total 16 bond issues through the EMTN route in UAE, 10 bond issues were from Dubai. The Government of Dubai also issued three bonds through the EMTN route. Egypt-based African Export-Import Bank (Afreximbank) also came up with an EMTN issue of US$300 million on November 13, 2009. The issue had a coupon rate of 8.75% and maturity period of five years. The Dubai government also issued another bond worth US$5 billion through the EMTN route on November 14, 2009. The bond has a coupon rate of 4.0% and maturity period of five years. Another issue came from Dubai DOF Sukuk on November 25, 2009, which amounted to US$500 million with a coupon rate of 4% and maturity period of five years.

Until now in 2010, seven bonds have been issued through EMTN route in the UAE

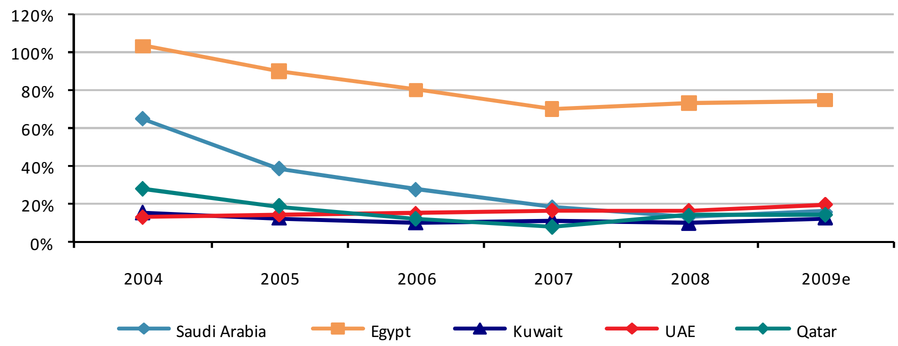
In 2010, a total of seven bonds have been issued in UAE through the EMTN route. All these bonds were from banking entities in the UAE. Saudi Arabia's Banque Saudi Fransi issued EMTN totaling US$650 million on March 30, 2010. The bond has a coupon rate of 4.25% and maturity period of five years.

Issues have become a popular source of financing in the MENA region, especially in those Emirates and countries that have lesser proportion of oil revenues compared to other regional peers. However, in other Islamic countries in East Asia (such as Malaysia), the EMTN program does not seem to be popular. In the past five years, there were no EMTN issues from Malaysia. Although financial institutions and government agencies in Malaysia came up with medium-term notes to raise money, they were not denominated in Euro.

Sovereign credit profile

In early 2000, the MENA economies were having huge public debt as oil revenues were low and the region's huge expenditure plans after the liberalization phase demanded massive investments. However, after 2007, with the surging oil prices, most of the MENA countries accumulated huge fiscal surpluses. Consequently, the debt burden of these nations started falling. Saudi Arabia's public debt reduced from SAR604.8 billion in 2004 to SAR235.6 billion in 2008. During the same period, its public debt to GDP ratio also came down from 65.0% to 13.3%.

Exhibit 22: **Public debt as a % of GDP in major MENA economies**



Source: IIF

Public debt as a % of GDP reduced drastically in MENA economies since 2004; however again expected to rise in 2009

Nevertheless, as the oil prices started decreasing from Q2 2008 owing to the global economic crisis, the Saudi Government's surpluses reduced. Hence, the government needed funds to cater to its huge expenditure plans. Consequently, the volume of public debt is expected to rise to SAR223.4 billion in 2009 (16% of GDP).

Bond market intermediaries

HSBC Plc has been consistently ranked as the top underwriter in the MENA bond market since past five years

Most of the underwriters of bond and sukuk issuances in the MENA region since past years have been foreign companies. HSBC Bank Plc has achieved first rank in terms of amount as well as the number of issues raised since 2006. The Company attained first rank four out of five times in the past five years. Between 2006 and 2010, HSBC Bank has raised 91 issues of bonds and sukuks totaling US$24.7 billion. Other foreign banks such as Standard Chartered Plc, Barclays Capital, Goldman Sachs & Co and Citibank have also been among the top ten underwriters for MENA region bonds since 2006. Some of the MENA region banks such as Samba Group Financial, National bank of Abu Dhabi, Emirates NBD PJSC, Riyad Bank and Dubai Islamic Bank were also listed among the top ten bond underwriters since 2006. The list of top 10 underwriters in the MENA region for the period 2006 – 2010 is mentioned in the Appendices section at the end of the report.

Bond rating (sovereign and corporate)

MENA bond rating landscape is dominated by large global rating agencies; there are no local rating agencies. This is in line with the small and underdeveloped bond markets in the region. Hence, most bonds (both sovereign and corporate) in the region are usually rated by global credit rating agencies such as Standard & Poor's (S&P), Fitch, and Moody's Investors Service (Moody's). However, international rating agencies such as S&P have formulated separate methodology for rating Sukuks. S&P has also come with a separate rating scale for the GCC region on February 16, 2010. The new region-specific rating scale is targeted at debt issuers in local currencies. S&P stated that by creating a regional rating scale, it is allocating more rating symbols that would capture the entire risk spectrum and give a clearer picture of lenders and investors.

MENA bonds are rated by foreign rating agencies as the region lacks its own rating agency

According to a report by Markaz, during 2009, 45 bond issuances (81.8% of the total issues) were rated in the GCC region by either one of the global rating agencies. Moody's stated that the average rating in the GCC region has changed from A1 in 2008 to Baa1 in 2009. This is due to the downgrades of many regional issuers. Most downgrades were of the Dubai government and corporate bonds, mainly due to uncertainty in their repayment schedule. Rating agencies were also worried about the amount of government support received by bond issuers in Dubai.

Comparison of cost of bonds to lending rates in key MENA markets

Financing through bond market route is relatively cheaper than bank financing in MENA

Bonds score better over the bank lending across MENA region in terms of cost of funding. The average bank lending rate in the UAE stood at 7.8% in 2008. On the other hand, the coupon rate of conventional bonds in the UAE—MENA's most popular bond market—ranged between 0% and 7.25% (excluding only one bond issued by Vontobel Dubai on June 17, 2008 with a coupon rate of 17.25%) in 2008**.** However, if a bond issuer has to issue new bonds, yield would be a better indicator of probable cost of issuing such a bond. In UAE, current bond yield is very near to their coupon rates. Several zero-coupon bonds were also issued in 2008. Among the corporate bond issuances, Nakheel Development issued US$750 million of bond on January 16, 2008, with a coupon rate of 2.75% and a maturity period of five years. Current yield on Nakheel's bond is 2.43%. Emirates Bank came up with six bond issues that had coupon rates ranging from 1.7–5.6% and maturity between 3 and 10 years. Current yield on Emirates Bank bonds is also very close to the respective coupon rates and they are much lower than the average bank lending rates, which clearly indicates that bonds are a cheap source of funding relative to bank lending. Even companies such as DEWA Funding Limited and RAK Capital came up with sukuks with a coupon rate of 6 months EIBOR + 125 bps and 3 months EIBOR + 115 bps, respectively (3 month EIBOR ranged between 1.86% and 4.79% in 2008).

Exhibit 23: **Coupon rate and current yield of major bond issues in MENA region**

Bond Name	Region	Coupon (%)	Yield (%)	Issue year	Maturity year
Nakheel Develop 2	UAE	2.8	2.4	2008	2011
Emirates Bank	UAE	5.6	5.4	2008	2018
Emirates Bank	UAE	5.6	5.4	2008	2018
Dolphin Energy	UAE	5.9	5.4	2009	2019
Emirates Bank	UAE	2.6	2.7	2009	2011
Emirates Bank	UAE	2.5	2.3	2009	2011
Emirates Bank	UAE	1.8	2.0	2009	2011
Emirates Bank	UAE	5.0	4.8	2009	2012
Egypt Govt bond	Egypt	9.2	9.2	2008	2014
Egypt Govt bond	Egypt	10.7	10.6	2008	2015
Egypt Govt bond	Egypt	8.7	8.7	2008	2016
Egypt Govt bond	Egypt	11.0	10.9	2008	2016
Egypt Govt bond	Egypt	9.2	9.1	2008	2018
Global Investment	Kuwait	5.0	5.0	2008	2013
Global investment	Kuwait	7.0	7.0	2008	2013
Gulf Investment	Kuwait	4.0	4.0	2008	2013
Gulf Investment	Kuwait	4.5	5.0	2008	2023
Kuwait Govt bond	Kuwait	1.5	1.6	2009	2010
Kuwait Govt bond	Kuwait	1.5	1.5	2009	2010

Source: Bloomberg

In 2009, conventional bond coupon rates in the UAE were in the range of 0–21.75%. Dolphin Energy announced a bond issue of US$1.25 billion on July 30, 2009, with a coupon rate of 5.88% and a maturity period of 10 years. Current yield on Dolphin Energy's bond is 5.40% Emirates Bank also issued four bonds with coupon rate in the range of 1.8–4.9% and current yields ranging between 1.9–5.4%. TDIC Sukuk Limited (TSL) and Saudi Electricity Company also came up with their sukuks with a coupon rate of 4.95% and 3-months EIBOR + 160 bps.However, the estimated average lending rate in the UAE stood at 5.9% during the same period.

In Egypt, the conventional bond coupon rate was 0–11.5% in 2008. The government alone issued five bonds with coupon rates of 8.7–10.95% during the same period. Even the current yield on Eygptian government bonds fall in the range of coupon rates. In the corporate sector, Egypt's National Investment Bank introduced four zero-coupon bond issues. During the same period, the average bank lending rate stood at 12.3%, higher compared to the coupon rate on bonds.
In 2009, most of the conventional bonds in Egypt were issued by the government. The coupon rate of bond issues was in the range of 0–12.8% in 2009. The average bank lending rate stood at 12.0% during the same period.

In 2008, the Kuwaiti economy did not witness any conventional sovereign issue; all of the issues were from the corporate sector—prominent among these were Global Investment House and Gulf Investment Corporation. The coupon rate was around 3.9–7.0%. As far as sukuks are concerned, Villamar Sukuk Company Limited of Kuwait came up with sukuk of US$190.0 million with a coupon rate of 3-months LIBOR + 275 bps.The average bank lending rate stood at 7.6% during the same period. The scenario reversed in 2009, when Kuwait's bond market witnessed several sovereign issues, each with a coupon rate of 1.5%. The average bank lending rate also declined to an estimated 6.0% during the same period. Nevertheless, bond financing was considered more lucrative due to lower coupon rates in 2009.

Exhibit 24: **Average bank lending rate (in %) in major MENA economies**

Country	2005	2006	2007	2008	2009	2010F	2011F
Bahrain	7.9	8.1	8.4	8.3	8.1	8.1	8.4
Egypt	13.1	12.6	12.5	12.3	12.0	11.8	12.0
Lebanon	10.6	10.3	10.3	10.0	9.6	9.1	9.1
Qatar	6.7	7.2	7.4	6.8	7.0	5.9	6.4
Algeria	8.0	8.0	8.0	8.0	8.0	8.0	8.0
UAE	7.2	7.9	8.0	7.8	5.9*	5.2	5.5
Kuwait	7.5	8.6	8.5	7.6	6.0*	5.2	5.3

*Source: EIU, *Estimated by EIU, F - forecast*

Debt/equity, Interest Coverage ratios of listed companies in MENA versus other markets and scope for growth

MENA region companies have high debt burden compared to its global counterparts

We have chosen the top 10 companies in the MENA region based on current market cap for our analysis. Furthermore, we have taken the top 10 companies (on the basis of current market cap) from other markets (the US, the UK, China and India) for peforming a comparative analysis. As far as Debt/Equity ratio of MENA companies is considered, the companies have high debt burden compared to global peers. The average Debt/Equity ratio of the top 10 companies in the MENA region is 53.9% as against the 27.9% of the global market peers.

Interest Coverage ratio of the top 10 companies in the MENA also indicates the region is burdened with huge debt. On the other hand, other global companies enjoy a relatively better debt position. The MENA region companies have an average interest coverage ratio of 29.6, while other global market peers recorded the ratio at 179.9.

Exhibit 25: **Debt ratios of MENA companies**

Company	Debt/Equity-2009 (%)	EBIT/Total Interest Expenses-2009	Current Market Cap (US$ bn)
SABIC	70.6	6.4	72.2
Etisalat	11.6	14.2	23.1
Mobile telecomm	86.9	3.2	20.7
Saudi Telecom Co	61.6	9.3	20.5
Industries Qatar	31.5	33.3	16.3
Maroc Telecom	21.0	61.4	16.1
Etihad Etisalat	70.2	15.7	10.3
SAFCO	8.4	145.4	9.7
Orascom Construction	78.7	5.4	9.3
DD World Ltd	99.2	1.6	8.8
Average	**53.9**	**29.6**	

Source: Bloomberg
Note: Market Cap is as on Oct 7, 2010

Exhibit 26: **Debt ratios of global companies**

Company	Debt/Equity-2009 (%)	EBIT/Total Interest Expenses-2009	Current Market Cap (US$ bn)
Exxon Mobil Corp	8.3	27.0	325.1
Petrochina Co	25.8	22.2	281.5
Microsoft Corp	14.5	544.6	212.3
BHP Billiton plc	40.3	17.9	208.8
Berkshire Hathway	27.9	9.9	205.4
Rio Tinto plc	50.1	5.5	140.7
China Shenhua	38.8	11.7	78.5
Reliance Industries Ltd	62.8	18.9	76.7
Oil & Natural Gas Corp	7.0	184.0	66.8
Tata Consultancy Services	3.5	957.5	42.0
Average	**27.9**	**179.9**	

Source: Bloomberg
Note: Market Cap is as on Oct 7, 2010

Size and number of defaults of bonds in MENA

MENA saw its first sukuk default in 2009, when Kuwait-based Islamic firm Investment Dar failed to honor its US$100 million obligation

In the last year and a half and as a result of the financial crisis, the MENA region has witnessed a handful of companies defaulting on Sukuk repayments at maturity. The first default in the region was witnesed in 2009, when Kuwait-based Islamic firm Investment Dar failed to pay for a US$100 million Islamic debt issue in May 2009. In Dubai, Nakheel Development also defaulted on a massive US$3,520 million sukuk in November 2009. Both sukuks were later restructured and the debt repayment process is ongoing. As part of the restructuring plan, Investment Dar presented a revised budget and 5-year business plan to the Coordinating Committee on May 24, 2010.

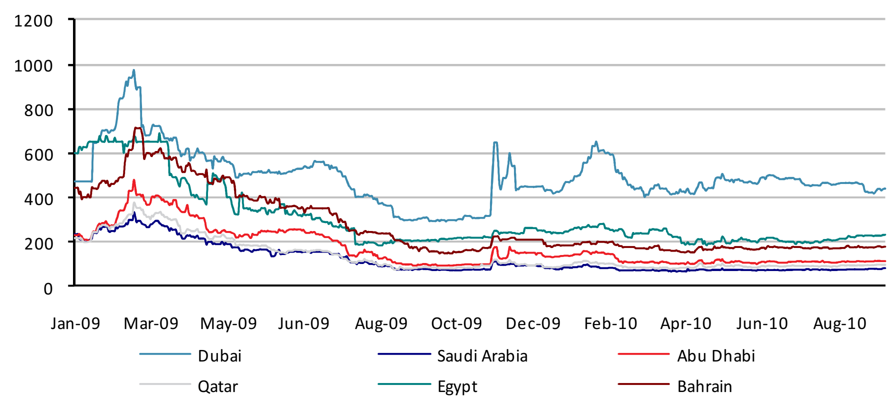
Regarding Nakheel, as on October 4, 2010, the company has achieved 85% acceptance from its trade creditors for restructuring its debts. Nakheel has already paid AED3.4 billion to its trade creditors until now. The company has also announced that it is working closely with its creditors to achieve 95% acceptance of all payables and claims by the end of 2010. As part of its restructuring plan, Nakheel plans to issue a AED6 billion Islamic bond and recommence the construction of its short-term projects. Furthermore, in April 2010, International Investment Group of Kuwait failed to honor its repayment commitment on a US$200 million Sukuk on maturity date.

Impact of Dubai and European debt crisis on the MENA debt markets

Dubai debt crisis resulted in widening of CDS spread only to stabilize following the restructuring of Nakheel's debt

Dubai's debt crisis started on account of the bubble burst in the real estate sector. This led to a six-month delay in the repayment of debt worth US$60 billion by state-owned entity Dubai World. The entity's borrowings also included a US$3.5 billion Islamic bond that was due to be repaid by Nakheel, the property developer of the Palm Jumeriah Islands. The announcement of debt repayment delay by Dubai World not only created mayhem in Dubai bond market, but also other regional bond markets. UK banks were among the 70 institutions that had provided loans to Dubai World. It included some big names in the banking arena, such as Royal Bank of Scotland (the biggest lender to Nakheel), HSBC, Lloyds Bank and Standard Chartered. Consequently, the global banking sector tumbled after the news of Dubai World crisis. Along with regional stock exchanges like DFM and ADSM, major world stock markets such as FTSE 100 and Dow Jones also plummeted. Moreover, the Dubai debt crisis adversely impacted the debt issuance volume in the bond market, mainly the sukuk issues. It also widened the CDS spread; Dubai's five-year CDS spread more than doubled to reach 647 bps on November 27, 2009 from 294.18 bps on October 27, 2009. As a result, all major MENA region countries witnessed a similar widening in CDS spread. Rising global uncertainty and problems related to restructuring of debt dampened the growth in bond markets in Dubai and the broader MENA region. Nevertheless, the debt restructuring plan of US$26 billion announced by the Dubai government at the end of November 2009 resulted in the narrowing of CDS spread for the emirate to 569.56 bps. Moreover, the aid of US$10 billion from neighboring emirate Abu Dhabi during December 2009 somewhat eased the uncertain market environment and stabilized CDS spread of Dubai that had reached 446.95 bps at the end of December 2009. As of September 2010, the restructuring process of Dubai World's debt repayment was on the verge of completion. Dubai World announced that 99% of its creditors had agreed to the terms for restructuring debt worth US$24.9 billion. Also, Dubai World expected to complete the restructuring process soon. Nakheel's debt restructuring process is also expected to be completed by year end. Consequently, the CDS spreads of MENA economies especially Dubai remained stable in the third quarter of 2010. Infact, Dubai's CDS spread reached 385.83 level on October 13, 2010.

Exhibit 27: **CDS spread trend on MENA region bonds (bps)**

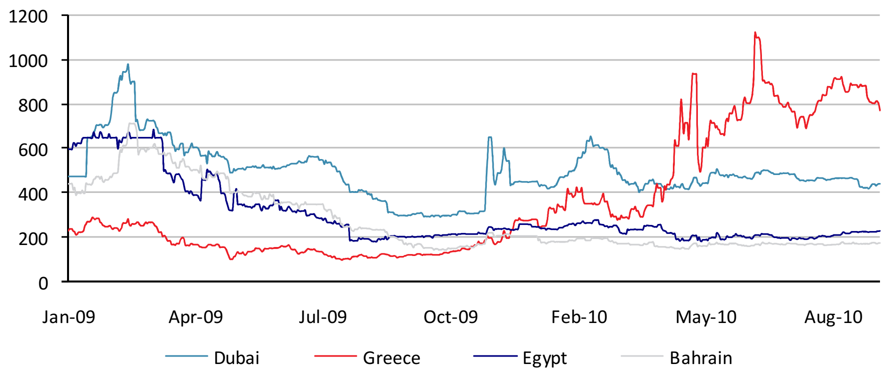


Source: Bloomberg

Greece debt crisis added to the woes of MENA debt markets and hindered its growth during early 2010

As the bond market in the MENA region started recovering from the shockwaves of Dubai debt in the first quarter of 2010, another global debt crisis – the Greek debt crisis – started. The contagion effect was felt in the MENA region too. Dubai's CDS spread increased to 651.3 bps in mid-February 2010 from 422.87 bps in mid-January 2010. This created worries over the rise in borrowing costs, which could dampen bond market activities in the MENA region. Nevertheless, the situation improved during May 2010, when various European Union governments announced US$1.0 trillion rescue plan in order to save the debt ridden economies in Europe. Consequently, the Dubai CDS spread came down to 488.14 bps on May 21, 2010. However, the Greek contagion affected other European economies such as Portugal and Spain. This is still a cause of worry for the global bond markets, including those in the MENA region. Hence, investors are still cautious about a slow recovery, which may hinder growth in bond markets.

Exhibit 28: **CDS spread comparison – Major MENA economies vs Greece (bps)**



Source: Bloomberg

Outlook

During the first half of 2010, many bonds were issued from Bahrain, Abu Dhabi, Saudi Arabia, Egypt and Dubai in the MENA region. The most prominent were – Saudi Electricity Company's (Saudi Arabia) SAR7.0 billion issue having a coupon rate pf 1.7% and maturity period of 20 years; DEWA's (Dubai) US$1.0 billion issue with a coupon rate pf 8.5% and maturity period of five years; Egypt government's EGP10 billion bond issue with a coupon rate of 12.25% and a maturity period of five years. According to Markaz, GCC region's total sukuk and bond issuances totalled US$24.2 billion in H1 2010. The large issuances have provided stability to MENA bond markets, thereby giving positive signal for the future performance. The recovery in oil prices and the high amount of economic activity in the form of massive investments in non-oil sectors would aid the future growth of debt markets in the region. The huge sukuk pipeline for 2010 and 2011 indicates towards expansion of debt financing in the region. Moreover, an improved regulatory structure in the form of development of secondary bond markets would lead to more transparency. Global economic uncertainty and the fragile recovery in European debt markets are the near term risk factors. However, we expect the MENA's strong structural drivers to support the growth of the region's bond market in the long term.

Appendix

Exhibit 29: **2010 League table for bonds – MENA Region**				
Underwriter	**Rank**	**Mkt Share (%)**	**Amount US$ (mn)**	**Issues**
HSBC Bank PLC	1	28	6,865.40	25
Standard Chartered PLC	2	8	2,070.28	11
Deutsche Bank AG	3	8	1,962.50	8
Barclays Capital	4	6	1,515.25	4
Samba Financial Group	5	5	1,166.62	2
RBS	6	5	1,125.00	3
JP Morgan	7	5	1,112.50	4
Morgan Stanley	8	4	1,083.33	4
BNP Paribas Group	9	4	983.33	3
Citi	10	3	833.33	4

Source: Bloomberg

Exhibit 30: **2009 League table for bonds – MENA Region**				
Underwriter	**Rank**	**Mkt Share (%)**	**Amount (USD (mn)**	**Issues**
HSBC Bank PLC	1	14	5,475.76	24
Goldman Sachs & Co	2	9	3,566.67	9
Barclays Capital	3	8	3,380.78	10
Credit Suisse	4	8	3,182.76	11
BNP Paribas Group	5	7	2,875.00	12
Citi	6	7	2,868.33	11
JP Morgan	7	7	2,866.67	8
Standard Chartered PLC	8	6	2,394.15	11
Deutsche Bank AG	9	4	1,625.00	5
National Bank of Abu Dhabi	10	4	1,555.12	5

Source: Bloomberg

Exhibit 31: **2008 League table for bonds – MENA Region**				
Underwriter	**Rank**	**Mkt Share (%)**	**Amount US$ (mn)**	**Issues**
HSBC Bank PLC	1	17	2,975.19	8
Standard Chartered PLC	2	12	2,163.94	11
Emirates NBD PJSC	3	8	1,429.35	4
JP Morgan	4	8	1,337.53	5
Credit Agricole CIB	5	6	1,016.56	2
Credit Suisse	6	6	1,005.93	3
Banque Audi	7	5	878.31	2
Bank Vontobel AG	8	5	856.51	7
Barclays Capital	9	5	845.43	4
Dubai Islamic Bank	10	4	772.01	4

Source: Bloomberg

Exhibit 32: **2007 League table for bonds – MENA Region**

Underwriter	Rank	Mkt Share (%)	Amount US$ (mn)	Issues
Citi	1	19	6,541.37	18
HSBC Bank PLC	2	13	4,567.28	14
JP Morgan	3	11	3,637.38	9
Deutsche Bank AG	4	10	3,335.16	11
Standard Chartered PLC	5	8	2,575.00	25
Barclays Capital	6	6	2,017.80	9
Riyad Bank	7	3	1,066.47	1
Dubai Islamic Bank	8	3	1,028.78	3
Lehman Brothers	9	3	948.42	2
Credit Suisse	10	3	858.33	3

Source: Bloomberg

Exhibit 33: **2006 League table for bonds – MENA Region**

Underwriter	Rank	Mkt Share (%)	Amount US$ (mn)	Issues
HSBC Bank PLC	1	14	4,813.42	20
Barclays Capital	2	12	4,348.18	8
Goldman Sachs & Co	3	12	4,216.40	5
Dubai Islamic Bank	4	10	3,535.00	3
Credit Suisse	5	7	2,419.29	13
Citi	6	5	1,648.08	13
Lehman Brothers	7	4	1,478.28	5
BNP Paribas Group	8	4	1,375.79	10
Standard Chartered PLC	9	3	1,199.70	20
UBS	10	3	1,152.61	10

Source: Bloomberg

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