



The Arab Gulf States Institute in Washington

Building bridges of understanding



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Debt Dynamics, and State Finances in the Gulf

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About the Author

Robert Mogielnicki is a senior resident scholar at the Arab Gulf States Institute in Washington. He leads the *Next Gen Gulf* series examining technology trends in Gulf Arab states. An expert in the political economy of the Middle East and North Africa, Mogielnicki previously served as a human resource development consultant for an Oxford-based research consultancy that operated across the Gulf region. Prior to his consulting career, he worked in journalism, covering political and economic developments in post-revolutionary Egypt and Tunisia.

His book, *A Political Economy of Free Zones in Gulf Arab States*, was published by Palgrave Macmillan's international political economy series in April 2021. Mogielnicki has authored several book chapters on the politics and economics of Gulf Arab states. His work and commentary on the region have appeared in *Foreign Policy*, *Bloomberg*, *Axios*, *Forbes*, *Reuters*, *Nature*, *Financial Times*, *The Banker*, *The Washington Post*, *The Wall Street Journal*, *Vox*, *Los Angeles Times*, *S&P Global*, and the *Nikkei Asian Review*, among other prominent outlets.

Mogielnicki received his DPhil from the University of Oxford's Magdalen College, where he conducted research in conjunction with the Oriental Institute and Middle East Centre. Drawing on extensive fieldwork in the United Arab Emirates, Oman, Qatar, Bahrain, and Kuwait, his dissertation examines the political economy of free zones in Gulf Arab countries. He earned his MPhil in modern Middle Eastern studies from St Antony's College, University of Oxford and completed a master's thesis on labor policy formulation and implementation in the emirates of Abu Dhabi and Dubai. He received his BA from Georgetown University as a double major in Arabic and government, graduating magna cum laude and Phi Beta Kappa.

Executive Summary

Sovereign and corporate bond issuances proved to be crucial economic policy tools and financial instruments in Gulf Arab states during the extraordinary economic challenges of 2020. While there were several major bond deals announced in early 2021, the pace of issuances and eagerness to tap international bond markets is poised to slow across the Gulf for the second half of 2021 and into 2022. Bond issuances and their future implications will remain a central feature of the political economy of Gulf Arab states, but the urgency for most Gulf governments to raise funding from international capital markets has diminished following higher oil prices and rosier economic growth forecasts. Another sustained slide in oil prices, however, would renew pressure on government finances and likely increase the need for debt issuances.

The highest-rated sovereign issuers, such as Abu Dhabi and Qatar, are in the privileged position of accessing cheap debt opportunistically. Saudi Arabia continues to enjoy strong demand for its sovereign bonds, but the state's total financing needs remain considerable. Despite shakier finances, investors continue to view Omani bonds favorably, given the sultanate's fiscal reform trajectory, regular issuances, and solid yields. Bahrain combines high levels of government debt with an uncertain fiscal reform status, but previous external support from Gulf Cooperation Council member states – as well as the prospect of future economic aid packages – has helped the small country maintain access to capital markets. Kuwait's government and Parliament have been unable to agree on a new debt law, which has prevented Kuwait from issuing bonds since 2017.

Commercial entities across the Gulf Arab states, especially those in the energy sector, took advantage of strong demand for corporate debt in 2020-21. With the expectation for fewer funding commitments from regional governments, there are concerns that the debt held by some regional government-related entities may be headed toward unsustainable levels. Multibillion-dollar external sovereign debt maturities are looming for Oman and Bahrain over the coming years, but they, and other Gulf states, will have the option to refinance or restructure this debt. Meanwhile, Islamic bonds are in high demand and their market is underserved, creating cost-effective opportunities for Gulf-based issuers.

Introduction

The markets for conventional bonds and Islamic bonds (also known as sukuk) within Gulf Cooperation Council countries had a robust year in 2020. Sovereign and corporate issuances amounted to a record-setting \$132.7 billion in 2020, reflecting 16% year-on-year growth.¹ Sovereign issuers in the Gulf states, which sought to stem swelling budget deficits amid sharply declining oil prices, increased the value of their issuances by 25% over those in 2019. Meanwhile, the value of bond and Islamic bond issuances by corporations rose by a more modest 8%.

¹ "GCC Sovereign Issues Surge 25% to \$66bln in 2020," *Zawya*, February 3, 2020.

Gulf debt markets are set to decelerate slightly over 2021, as regional governments are in a stronger position to meet financing needs and Gulf-based firms emerge from the depths of the coronavirus pandemic-induced economic downturn in 2020. Higher oil and gas prices bode well for Gulf government finances: Public sector revenue still largely depends on proceeds from the oil and gas sector. By the end of August, Brent crude oil prices had averaged \$67 per barrel for the year,² and many analysts expect oil prices to stay within a \$60-\$70 per barrel range for the foreseeable future. GCC countries are expected to return to an aggregate growth rate of 2.2% in 2021, according to the World Bank.³

The frequent bond issuances and higher debt levels of 2020-21 will invariably invite comparisons to the 2009 global financial crisis and the oil price slide of 2014-15, when acute economic shocks heightened concerns over the sustainability of debt levels in the region. In economic squeezes over the past decade, sovereign and corporate issuers have, by and large, adroitly deployed debt instruments to blunt the impact of economic shocks and continue to manage fluctuating levels of leverage. Yet prevailing situations can always change. Assessments of debt dynamics in the Gulf region and the corresponding monetary and fiscal health of respective issuers at the sovereign and firm levels therefore demand continual attention. The underlying economic factors driving debt issuances, issues related to how raised funds are redeployed within local economies, and the implications of looming debt maturities help to paint a comprehensive picture of the state of Gulf Arab economies.

The Sovereigns: Gulf Country Cases

Debt remains a central economic policy mechanism for Gulf regional governments. In this context, the economic and political conditions in a particular country impact the cost-benefit analysis associated with assuming more debt, especially at the sovereign level. Debt ceilings must be raised; debt laws require approval; issuances need to be completed; and debt reduction plans must eventually be implemented.

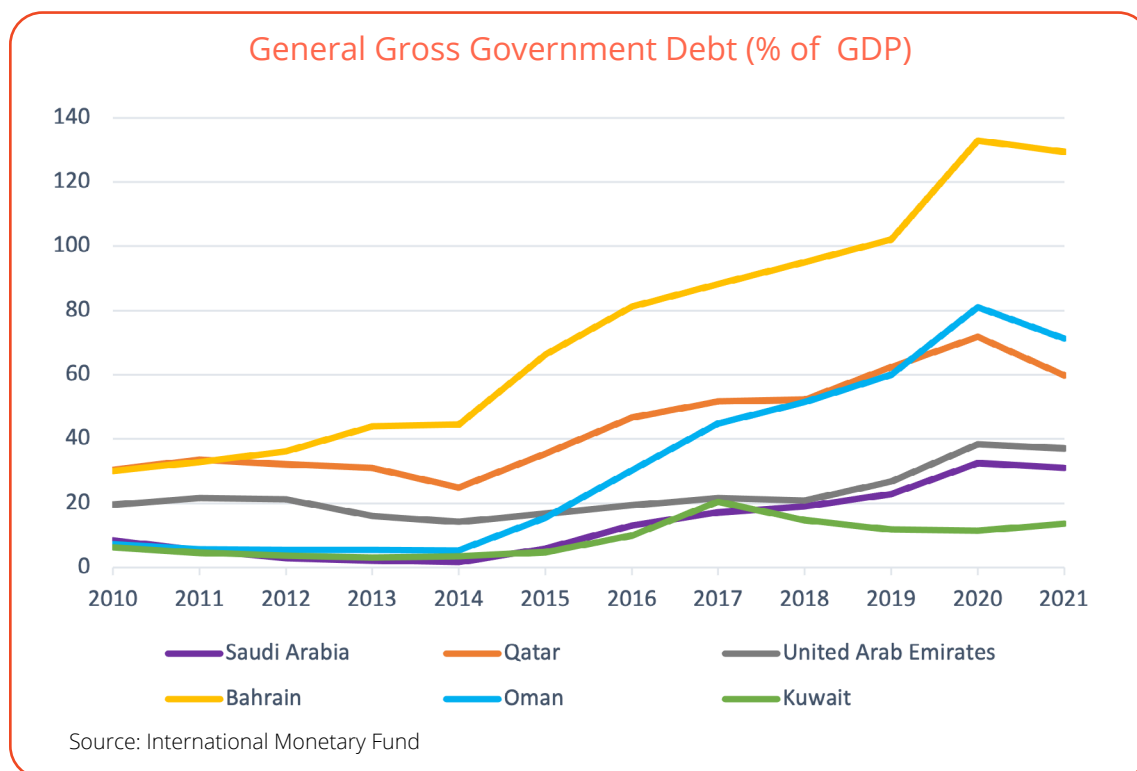
Despite political and policymaking hurdles, issuing debt continues to be an attractive economic policy option

Deep and sustained budget cuts as well as new taxes and fees directly impact the economic welfare of citizens and residents.

precisely because the alternatives, especially those to be implemented during economic downturns, are comparatively unpopular policy approaches. Deep and sustained budget cuts as well as new taxes and fees directly impact the economic welfare of citizens and residents. Drawdowns of sovereign wealth funds, especially those mandated to safeguard wealth for future generations, remain contentious. Meanwhile, privatizations offer one-off financial windfalls and depend largely on the availability of willing buyers.

² Eileen Soreng, "Oil Price Rise Outlook Stalls Over Delta Speed Bump," *Reuters*, August 31, 2021.

³ Isaac John, "GCC Set to Return to 2.2% Growth: World Bank," *Zawya*, August 5, 2021.



Saudi Arabia

Demand for Saudi debt remains strong, and Saudi officials took advantage of low interest rates throughout 2020-21. In January, Saudi Arabia raised \$5 billion through a dual-tranche bond sale. Then, in February, Saudi Arabia borrowed at negative interest rates for the first time, raising around \$1.8 billion in euro-denominated bonds.⁴ In other words, the country was paid to borrow. According to the National Debt Management Center of the Ministry of Finance, the level of gross debt raised in 2021 is expected to reach 124 billion Saudi riyals (approximately \$33.1 billion), with external debt constituting between 25% and 45% of the overall debt mix.⁵ Internal debt, or domestic debt, is the debt owed to lenders within the country.

Yet many of the market fundamentals that drove Saudi Arabia's funding needs in 2020 have changed. The value of Saudi oil exports increased by over \$25.7 billion in the second quarter of 2021, up 126% from the same quarter in 2020.⁶ On the other hand, the 2020 collapse in oil prices and cuts in oil output inflicted a traumatic shock on Saudi Arabia's budget. To address the unfolding economic crisis, Saudi officials sought to borrow more from local and international investors alongside delaying spending on Vision 2030 projects and revamping

⁴ Anna Hirtenstein, "Saudi Arabia Borrows at Negative Rates for First Time as Oil Recovers," *The Wall Street Journal*, February 24, 2021.

⁵ National Debt Management Center, "Annual Borrowing Plan Highlights: 2021," *Ministry of Finance of Saudi Arabia*, accessed September 20, 2021.

⁶ General Authority for Statistics, "International Trade Q2 2021," *Kingdom of Saudi Arabia*, accessed August 25, 2021.

the government's privatization strategy. The country raised \$12 billion from international debt markets in 2020.⁷ Saudi Arabia likewise raised its government debt ceiling from 30% to 50% of gross domestic product, providing greater borrowing flexibility.⁸

Saudi Arabia has enjoyed historically low levels of government debt as a ratio of GDP over the past decade. The International Monetary Fund forecasts that this ratio will remain between 31% and 32.4% from 2021-26.⁹ Fluctuations along this trend line may occur but are unlikely to be substantial: Saudi Arabia's debt-to-GDP ratio increased to approximately 35.6% in the first quarter of 2021, up from 32.3% at the end of 2020.¹⁰ Although Saudi Arabia's debt-to-GDP ratio edged upward, the ratio remains well below that of other Gulf states.

Tapping international bond markets – as well as borrowing locally – has the additional benefit of raising needed funding without short-term repercussions. Budget cuts can exert a material impact on the quality of life of citizens – especially public sector employees – and residents. Meanwhile, privatizations, while portrayed as pillars of economic diversification initiatives, are one-off sales of public goods. Privatization processes can be controversial and, if conducted under economic constraints, may not generate sufficient proceeds to warrant the sale. In July 2020, the Saudi finance minister stated, “We’re looking at sectors that haven’t been targeted before for privatization,”¹¹ owing to the need to raise funding from new sources. Yet one year later, Saudi Arabia halted the \$2 billion sale of the Ras Al-Khair desalination and power facility¹² – one of the world's largest water plants and a visible component of the country's ongoing privatization initiative. An official from the National Center for Privatization & PPP attributed the suspension to slowing responses from bidders owing to coronavirus-related factors.¹³

By contrast, debt is less controversial and is an increasingly familiar policy instrument in Saudi Arabia. “The reliance on debt is in line with the approach Saudi authorities have taken since 2016. It's a sound strategy as long as there's appetite from foreign investors for Saudi debt. But it also comes at the risk of tightening liquidity in the banking system if the government relies excessively on domestic borrowing,” according to Ziad Daoud at Bloomberg.¹⁴ Domestic borrowing ultimately reduces the supply of loanable funds and can crowd out private sector investment.

⁷ Yousef Saba and Davide Barbuscia, “MIDEAST DEBT-Abu Dhabi, Saudi Arabia Expected to Issue Bonds by End-2021 - Sources,” *Reuters*, September 7, 2021.

⁸ Vivian Nereim, Dana Khraiche, and Matthew Martin, “Saudi Arabia Raises Debt Ceiling to Borrow More As Oil Plummets,” *Bloomberg*, March 20, 2020.

⁹ “Saudi Arabia: General Government Gross Debt,” *International Monetary Fund*, accessed August 25, 2021.

¹⁰ “Saudi Public Debt Up 5.6% to \$240.4bl in Q1 2021,” *Zawya*, May 6, 2021.

¹¹ Davide Barbuscia and Marwa Rashad, “Saudi Arabia to Widen Privatisation Scope, Finance Minister Says,” *Reuters*, July 22, 2020.

¹² Matthew Martin and Verity Ratcliffe, “Saudi Arabia Halts \$2 Billion Sale of Water Plant Stake,” *Bloomberg*, July 26, 2021.

¹³ “Saudi Arabia Suspended World's Largest Desalination and Power Plant Privatization Due to Pandemic – Official,” *Arab News*, July 30, 2021.

¹⁴ Vivian Nereim, Matthew Martin, and Reema Al Othman, “Saudi Response to Fiscal Shock Centers on Record Debt Plan,” *Bloomberg*, April 22, 2020.

Qatar

The small country of Qatar has large sovereign net foreign assets and a “favourable outlook for debt reduction.”¹⁵ Thus, Fitch Ratings affirmed Qatar at “AA-” in June, while Saudi Arabia only received an “A” rating. Qatari officials have capitalized on strong demand for the country’s government bonds over the past few years. Between April 2018 and June 2021, Qatar issued \$34 billion in government bonds.¹⁶ Qatar raised \$12 billion in its 2018 issuance amid a boycott by neighboring Arab states as well as \$12 billion in a March 2019 offering.¹⁷ As part of its most recent issuance, the small Gulf country sold \$10 billion in bonds in a major – and significantly oversubscribed – deal that received more than \$44 billion in orders in April 2020.¹⁸

These recent issuances and other Qatari government efforts to enhance the country’s debt market have resulted in a sharp increase in government debt. However, the consensus is that Qatar’s government debt levels have not reached unsustainable levels. As a point of comparison, U.S. general government gross debt-to-GDP reached 133% in October, according to the International Monetary Fund.¹⁹ Qatar’s general government gross debt as a percentage of GDP stood at 59.8% in April, which is down from 71.8% in 2020 and 62.3% in 2019. Moreover, the IMF expects this figure to continue to edge downward over the next several years.²⁰

According to the Qatar Central Bank, government bonds are “one of the major government debt instruments used by the government to provide the necessary

The consensus is that Qatar’s government debt levels have not reached unsustainable levels.

liquidity for projects funding,” and they are considered “low-risk investment instruments.”²¹ S&P Global Ratings, however, warns that “short-term external debt accumulated by its large banking system,” is a vulnerability for Qatar.²²

Qatar’s relative isolation from oil price volatility, given its reliance on liquefied natural gas exports for government revenue, has enabled the small country to weather the coronavirus-induced economic downturn of 2020 in decent fiscal shape. The Qatari government planned for a minor surplus of 500 million Qatari riyals (approximately \$138 million); however, the country posted a deficit of 11.3 billion Qatari riyals (about \$3.1 billion) for the 2020 fiscal

¹⁵ “Fitch Affirms Qatar at ‘AA-’; Outlook Stable,” *Fitch Ratings*, June 18, 2021.

¹⁶ Simone Foxman, “Qatar May Sit Out Gulf Debt Binge as Oil Prices Boost Finances,” *Bloomberg*, June 22, 2021.

¹⁷ “Qatar Returns to Bond Market With a \$10bn Issuance,” *Economist Intelligence*, April 8, 2020.

¹⁸ Davide Barbuscia, Saeed Azhar, and Yousef Saba, “UPDATE4-Qatar Sells \$10 Bln Bonds as it Postpones Project Spending,” *Reuters*, April 7, 2020.

¹⁹ “General Government Gross Debt: United States,” International Monetary Fund, IMF Datamapper, accessed October 21, 2021.

²⁰ “Qatar: Country Data,” IMF, accessed August 19, 2021.

²¹ “Government Bonds,” Qatar Central Bank, accessed September 7, 2021.

²² “MENA Sovereigns, Corporates, and Banks Enter a New Chapter as COVID-19 Concerns Linger,” *S&P Global Ratings*, September 7, 2021.

year.²³ The opposite is likely to happen with Qatar's 2021 budget: Policymakers envisioned a deficit of 34.6 billion Qatari riyals (over \$9.5 billion);²⁴ however, a rebound in global energy prices should provide for a budget surplus.

Improved fiscal conditions in the first half of 2021 led Qatar's acting finance minister to state, "The only time we might need financing is just to improve our financial position"²⁵ such as refinancing outstanding debts and other "opportunistic" reasons for tapping bond markets. The budget surplus reached \$55 million in the first quarter and over \$1 billion in the second quarter of 2021.²⁶ With this strong government revenue, Qatar's financing needs for the remainder of 2021 and foreseeable future are significantly less urgent than what was envisioned throughout 2020. With the 2022 FIFA World Cup approaching, related project expenditures for the major event will eventually subside, further easing budgetary pressures.

The United Arab Emirates

In the UAE's federal government structure, the country's individual emirates have historically tapped bond markets. The federal government only passed its Public Debt Law in 2018,²⁷ which permitted the issuance of sovereign debt; however, the UAE government did not immediately issue federal bonds. Emirates Development Bank, which is owned by the federal government, became the first federal entity to take advantage of the law and issued bonds in 2019.²⁸ The new debt law and subsequent sovereign rating for the UAE – Fitch Ratings assigned the country the fourth-highest investment grade in November 2020 – have nevertheless seemingly enabled the country's smaller emirates to benefit from the strong sovereign rating.²⁹ In early October, the UAE's federal government hired a group of banks to arrange its debut bond sale.³⁰

While investors certainly factor in Abu Dhabi's funding commitments to other emirates in the country, Abu Dhabi nevertheless remains a top-rated sovereign.

The capital emirate of Abu Dhabi enjoys strong credit fundamentals, permitting the sovereign issuer to secure high investor demand for bonds with relatively low yields. While investors certainly factor in Abu Dhabi's funding commitments to other emirates in the country, Abu Dhabi nevertheless remains a top-rated sovereign. The oil-rich emirate presides over an economy that is relatively diversified at the federal level, and the UAE has enacted a number of commercial reforms to help support long-term economic growth.

Abu Dhabi has capitalized on its strong economic position and solid reputation in international debt markets. In April 2020, Abu Dhabi raised \$7 billion in a multitranche bond offering that included a 30-year tranche. In September 2020, Abu Dhabi completed a \$5 billion multitranche

²³ Ministry of Finance, "Statistics: Public Budget 2020," State of Qatar, accessed August 31, 2021.

²⁴ Ministry of Finance, "Qatar State Budget 2021," State of Qatar, accessed August 31, 2021.

²⁵ Simone Foxman, "Qatar May Sit Out Gulf Debt Binge as Oil Prices Boost Finances," *Bloomberg*, June 22, 2021.

²⁶ Ministry of Finance, "Statistics: Public Budget 2021," State of Qatar, accessed August 31, 2021.

²⁷ Sarah Townsend, "UAE to Issue Public Debt Law to Allow Federal Bond Issuance," *The National*, October 13, 2018.

²⁸ Dania Saadi, "Emirates Development Bank Launches \$750m Bond, First Issue Under New Debt Law," *The National*, March 2, 2019.

²⁹ Abeer Abu Omar, "UAE Gets First Rating From Fitch Ahead of Federal Bond Sale," *Bloomberg*, November 11, 2020.

³⁰ Yousef Saba, "UAE Federal Government Markets Three-Part Dollar Bonds in Debut Deal," *Reuters*, October 4, 2021.

bond offering, which included a 50-year bond – the longest term offered by a Gulf sovereign issuer.³¹ While Abu Dhabi's government debt jumped to 22.7% of GDP in 2020, up from 11.8% in 2019, this increase built upon a very low base.³² The chairman of the Abu Dhabi Department of Finance, Jassim Mohammed Buatabh Al Zaabi, said that the emirate's low direct government debt levels provided "substantial fiscal flexibility and the capacity to add debt."³³ This year, the emirate completed a \$2 billion bond issuance in June and a \$3 billion issuance in September.³⁴

Dubai has been less active in public debt markets than neighboring Abu Dhabi. In September 2020, Dubai sold \$2 billion in an offering split evenly between Islamic bonds and conventional government bonds, returning to debt markets for the first time since 2014.³⁵ Dubai successfully repaid \$750 million in bond certificates in October,³⁶ and the government completed a repayment of \$500 million in bonds in June, which the director general of the emirate's Department of Finance described as a reflection of Dubai's "deep fiscal stability."³⁷ However, the UAE's commercial hub has struggled to manage debt in the past, especially during the 2008-09 global financial crisis. Dubai remains unrated by the major credit rating agencies, which has raised questions about the outstanding total debt of government-related entities and may influence investor interest in future bond offerings.

The emirate of Sharjah has also participated in the regional bond rush. Sharjah raised a total of \$2.25 billion in 2020 to help offset a 24% slide in government revenue that occurred during the fiscal year. In July, Sharjah sold \$750 million in 10-year Islamic bonds, and the emirate sold \$1.25 billion in a two-tranche conventional bond deal completed in the first quarter of 2021.³⁸

Oman

In 2020, Omani policymakers had to contend with low and volatile oil prices, ballooning deficits, and a contracting economy. Oman's budget deficit reached about 18% of GDP in 2020, and debt to GDP jumped from 60% in 2019 to 79% in 2020. Yet Oman did not immediately tap capital markets in 2020, owing to higher borrowing costs. Oman's government instead asked banks to arrange an issuance of local Islamic bonds as well as local development bonds worth \$1.43 billion.³⁹ The Omani government meanwhile secured a \$2 billion, 1-year bridge loan from regional and international banks with the expectation that it would be repaid following an international bond issuance. By October 2020, Oman was ready to return to international debt markets and raised \$2 billion in 7- and 12-year bonds. Oman then sold \$3.25 billion in

³¹ "Abu Dhabi Issues \$5b in Multi-Tranche, 50-Year Bond," *Gulf News*, September 2, 2020.

³² "Moody's Affirms Abu Dhabi's Aa2 Ratings; Maintains Stable Outlook," *Moody's*, May 4, 2021.

³³ "Abu Dhabi Issues US\$7 Billion in Multi-Tranche Bonds," *Emirates News Agency*, April 19, 2020.

³⁴ "Abu Dhabi Completes USD 2 Billion 7-Years Sovereign Bond Issuance," Abu Dhabi Government Media Office, June 2, 2021.

³⁵ Yousef Saba and Davide Barbuscia, "Returning to Public Debt Markets After Six Years, Dubai Gets \$2 Billion," *Reuters*, September 15, 2020.

³⁶ Varun Godinho, "Dubai Repays 10-Year \$750m Bonds Certificates," *Gulf Business*, October 6, 2020.

³⁷ Davide Barbuscia, "Dubai Says \$500 Mln Bond Repayment Reflects Fiscal Stability," *Reuters*, June 22, 2021.

³⁸ Yousef Saba, "UPDATE1-Emirate of Sharjah Sells \$750 Million in 10-Year Sukuk," *Reuters*, July 6, 2021.

³⁹ Yousef Saba and Alaa Swilam, "Oman Will Tap Local and International Debt to Fill Cooffers," *Zawya*, September 9, 2020.

a three-part bond offering in January. The sultanate secured another \$1.75 billion in 9-year Islamic bonds after garnering \$11.5 billion in orders, reflecting strong demand for Islamic bonds.⁴⁰

A much-cited figure of Omani debt is that it increased from 6% of GDP in 2014 to 79% in 2020. The debt-to-GDP figure does not measure nominal debt levels but rather varies depending on the size of the Omani economy. According to the IMF, Oman's economy contracted by 6.4% in 2020,⁴¹ which would result in a larger debt-to-GDP ratio even if gross debt levels remained unchanged. Conversely, a return to growth, which the IMF expects to register 2.5% in 2021,⁴² will serve to reduce this ratio. Key ratings agencies expect Oman's total debt-to-GDP ratio to edge slightly downward to around 75% over the coming years.

From a debt perspective, Oman is not necessarily in the hot economic water that some observers suspect. Oman does have a "junk" credit rating – making the sultanate the only other junk-rated Gulf sovereign apart from Bahrain. However, many investors view Oman favorably because it is a frequent issuer and offers comparably high-yielding investments. The country also possesses higher financial buffers than neighboring Bahrain, for example. The Oman Investment Authority oversees approximately \$17 billion in assets,⁴³ and the country's central bank holds a comparable amount of foreign assets.⁴⁴ More importantly, the Omani government under Sultan Haitham bin Tariq al-Said has given credible assurances to global investors that the country is on a promising fiscal path with concrete initiatives, such as the introduction of a value-added tax and a mid-term fiscal balance program. Omani officials have likewise utilized the prospect of financial support packages from wealthier Gulf neighbors to ease investors' concerns without actually receiving this form of external support. Despite difficult economic conditions, Omani authorities have thus far managed to secure financing on their terms, reducing for now concerns that an economic bailout would come with strings attached.

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Rising oil prices have been a helpful development. The price of Omani crude oil exceeded \$70 per barrel on June 4, and Omani crude on the Dubai Mercantile Exchange averaged \$66.40 per barrel for its July delivery.⁴⁵ The Omani government factored in an expected oil price of \$45 per barrel into the 2021 budget, providing the government with a degree of fiscal maneuverability. Oman's economy is expected to grow at a rate of around 2.5% in 2021 and 3% in 2022, though the country's economic recovery is a fragile one.

⁴⁰ Yousef Saba, "Oman Gets \$1.75 Billion as Sukuk Comeback Sees Huge Demand," *Reuters*, June 8, 2021.

⁴¹ "Oman Economy Shrank 6.4% in 2020, IMF Says," *Reuters*, February 12, 2021.

⁴² "Oman: Staff Concluding Statement of the 2021 Article IV Mission," *IMF*, July 6, 2021.

⁴³ "Oman Investment Authority," Sovereign Wealth Fund Institute, accessed August 26, 2021.

⁴⁴ "Monthly Statistical Bulletin," Central Bank of Oman, June 2021.

⁴⁵ "Oman Crude Oil Price on DME Crosses \$70 a Barrel," *Hellenic Shipping News*, June 7, 2021.

Bahrain

The fiscal state of Bahrain and the consequent debt dynamics are in a more critical state than those of its Gulf neighbors. The ratio of general government gross debt to GDP has risen precipitously from 12.6% in 2008 to 129.4% in April.⁴⁶ IMF forecasts predict this debt ratio will steadily increase to 152.5% by 2026. Public sector revenue remains inextricably tied to proceeds from hydrocarbon exports, and the country possesses low levels of foreign currency reserves. On May 28, S&P Global Ratings revised Bahrain's outlook to "negative," stating that "the tentative pace of fiscal reform is insufficient to stabilize Bahrain's debt to GDP over the next few years."⁴⁷

Urgent financing needs in 2020 and early 2021 pushed Bahrain to complete international debt sales to help shore up its finances. The 2020 state budget deficit increased to 12.8% of GDP in 2020, up from 4.7% in 2019.⁴⁸ Although the Bahraini government anticipates deficit reductions as part of its Fiscal Balance Program reboot, which includes government plans to raise the VAT rate to 10% from 5%, year-on-year budget deficits are likely to continue over the short term. Fitch Ratings forecasts the 2021 budget deficit to fall to 7.9% of GDP and remain at around 8% of GDP (excluding extrabudgetary spending) for the next few years.⁴⁹ The persistence of higher oil prices and the hike in the VAT rate set to begin in January 2022 would help contain future deficits.

If international demand for Bahraini bonds dries up, this external backing will no longer function as a support mechanism but rather become a financial lifeline of last resort.

In the first quarter of 2020, Bahrain secured a \$1 billion loan to manage the maturity of a \$1.25 billion eurobond. The government raised another \$2 billion through a dual-tranche issuance in May 2020, but there was a substantial yield premium, given that Bahrain was the lowest-rated country selling dollar bonds since the beginning of the coronavirus pandemic in early 2020.⁵⁰ Despite the troubled fiscal balance sheet, the issuance was oversubscribed, an indication that many institutional investors seeking higher yields believed that Bahraini bonds were worth the risk. In September 2020, Bahrain raised \$2 billion as part of a dual-tranche issuance consisting of 7-year Islamic bonds and 12-year conventional bonds.⁵¹ In January, Bahrain raised another \$2 billion in a three-part bond sale to help finance its expected deficit. According to Fitch Ratings, the country faces external bond amortizations of approximately \$2 billion per year from 2022-24.⁵²

⁴⁶ "Kingdom of Bahrain: Country Data," IMF, accessed August 31, 2021.

⁴⁷ Nilanjana Basu, "S&P Revises Bahrain's Outlook to 'Negative' on Continued Fiscal Pressures," *Reuters*, May 28, 2021.

⁴⁸ "IMF Staff Completes 2021 Article IV Mission to the Kingdom of Bahrain," *IMF*, February 14, 2021.

⁴⁹ "Bahrain Seeks to Reboot its Fiscal Balance Programme," *Fitch Ratings*, September 28, 2021.

⁵⁰ Archana Narayanan and Netty Idayu Ismail, "Bahrain Sells Riskiest Eurobond Since Market Reopened," *Bloomberg*, May 7, 2020.

⁵¹ Yousef Saba, "Saudi 'Proxy' Bahrain Grabs \$2 Billion With Bond Comeback," *Reuters*, September 15, 2020.

⁵² "Bahrain Seeks to Reboot its Fiscal Balance Programme," *Fitch Ratings*, September 28, 2021.

External financial support from neighboring Gulf countries provides an important backdrop to Bahraini debt dynamics. In October 2018, GCC member states pledged a \$10 billion aid package for Bahrain, temporarily alleviating growing concerns about the country's finances. Indeed, the continued prospects of "strong financial backing from partners in the Gulf Cooperation Council," supports Bahrain's ratings.⁵³ Yet if international demand for Bahraini bonds dries up, this external backing will no longer function as a support mechanism but rather become a financial lifeline of last resort.

Kuwait

Kuwait has recently had a complicated relationship with debt. The country has not issued a sovereign bond since 2017, as Kuwait's ruling family-led government and the Parliament have not been able to agree on acceptable terms for a sovereign issuance. In August 2020, the Parliament refused to pass a public debt law proposed by the government, which sought to enable Kuwait to borrow \$65.4 billion over 30 years.⁵⁴ In theory, Emir Nawaf al-Ahmed al-Sabah, who assumed power in September 2020, could enact a debt law through an emergency executive decree, but he has not yet resorted to this option.

Rather, the Kuwaiti government has focused on accessing existing fiscal resources. The Parliament approved a

In the absence of progress on debt reform, and without a substantial and sustained improvement in state finances, it is unclear what other steps the Kuwaiti government may take to meet future financing needs.

law in August 2020 making transfers of state revenue to the Future Generations Fund, one of the country's sovereign wealth funds, dependent upon a fiscal surplus. The law frees up 10% of total state revenue, which is expected to reach \$36 billion according to the country's 2021-22 budget,⁵⁵ during years with deficits to be used for other financing needs. Moreover, the government sought permission to withdraw as much as \$16.5 billion per year from the Future Generations Fund to finance deficits, but this additional measure has not yet been approved by lawmakers.⁵⁶

In the absence of progress on debt reform, and without a substantial and sustained improvement in state finances, it is unclear what other steps the government may take to meet future financing needs. The General Reserve Fund, which the government traditionally uses to meet short-term financing needs, might borrow from the Future Generations Fund – a less controversial option than transfers from the Future Generations Fund provided the loan can be repaid. In February, Fitch Ratings affirmed Kuwait's Long-Term Foreign-Currency Issuer Default Rating at "AA" but revised the outlook to "negative" from "stable," citing the risks around the depletion of liquid assets in the country's wealth funds.⁵⁷

⁵³ "Rating Report: Bahrain," *Fitch Ratings*, May 10, 2021.

⁵⁴ Ahmed Hagagy, "UPDATE1-Kuwait Parliament Approved New Wealth Fund Law, Delays Debt Reform," *Reuters*, August 19, 2020.

⁵⁵ "Kuwait 2021-2022 Budget Projects USD 76 Bln in Expenditure – Minister," *Kuwait News Agency*, June 22, 2021.

⁵⁶ Fiona MacDonald, "Kuwait Seeks Approval to Use Wealth Fund to Finance Deficit," *Bloomberg*, February 22, 2021.

⁵⁷ "Fitch Revises Kuwait's Outlook to Negative; Affirms at 'AA,'" *Fitch Ratings*, February 2, 2021.

The massive assets held in Kuwaiti wealth funds, namely the Future Generations Fund, therefore serve as a blessing and a curse. Ratings agencies and multinational financial institutions, like the IMF, consider the cumulative sovereign holdings important fiscal buffers. However, the size of these assets and their significance for the Kuwaiti public make them a political hot potato. In August, Kuwait's Cabinet established a committee on the governance of the sovereign credit rating,⁵⁸ acknowledging that the country's economic policymaking inertia is taking a toll on the country's credit rating.

Firm-Level Debt Dynamics

Gulf Arab governments are not the only regional entities engaged in bond issuances to access inexpensive debt. Companies across the Gulf are taking advantage of strong demand for corporate bond offerings – this is especially the case for state-owned energy companies in the Gulf.

Saudi Arabia's state-owned energy company, Saudi Aramco, has relied on corporate bond issuances to help meet its dividend payments. Aramco pledged to pay an annual dividend of \$75 billion as part of its initial public offering in 2019, which proved to be an especially taxing financial commitment. Aramco completed a debut \$12 billion bond sale in 2019, an \$8 billion offering in November 2020, and a \$6 billion Islamic bond in June.⁵⁹ Cheap financing is difficult for Aramco to turn down; however, borrowing to meet dividend obligations, despite demand for its corporate bonds, does not necessarily project long-term fiscal strength. Additional financing needs may be on the horizon. The Saudi government's public-private partnership program, Shareek, seeks to augment capital expenditures by encouraging companies like Aramco and other national champions to boost corporate investments in the country's private sector.⁶⁰

Cheap financing is difficult for Aramco to turn down; however, borrowing to meet dividend obligations, despite demand for its corporate bonds, does not necessarily project long-term fiscal strength.

State-owned Qatar Petroleum sold \$12.5 billion in dollar bonds in June to help finance its gas production expansion plans. The company's last dollar bond issuance was in 2006, when the company raised a modest \$650 million.⁶¹

⁵⁸ Omar Fahmy and Nayera Abdallah, "Kuwait's Cabinet Says It Has Ordered a Spending Cut From Current Budget of At Least 10%," *Reuters*, August 16, 2021.

⁵⁹ "Saudi Aramco Raises \$6 Billion in Debut Islamic Bond Sale," *AFP*, June 17, 2021.

⁶⁰ "'Shareek' Program Aims to Strengthen Cooperation Between Public and Private Sectors," *Saudi Press Agency*, March 31, 2021.

⁶¹ Archana Narayanan and Verity Ratcliffe, "Qatar Petroleum Sells \$12.5 Billion of Bonds for Gas Push," *Bloomberg*, June 29, 2021.

The Omani government established Energy Development Oman in December 2020, and the new entity is responsible for raising its own financing through borrowing or bond issuances. In August, in Energy Development Oman's first financing transaction, the company raised \$2.5 billion in an oversubscribed bond.⁶² The Omani government's move signals its broader intention to reduce the direct financial burden posed by government-related entities.

Ongoing economic constraints and shifting governmental priorities could push state-owned entities and government-related entities across the Gulf to take on more debt. Indeed, ratings agencies have raised concerns about high and rising levels of debt held by government-related entities in Oman, Qatar, and Dubai.⁶³ Deciphering the state of government-related entities' finances is challenging, given the opaque processes that screen off much of the data on which such decisions are based. Yet even if financial commitments from respective governments may not be entirely transparent, Gulf government-related entities will be cautious about taking on significantly more debt, especially through tapping international markets, amid fragile economic recoveries.

As part of economic recovery efforts, regional governments want to minimize fiscal and monetary vulnerabilities. Sultan Haitham has tasked the Oman Investment Authority with consolidating the government-related entity sector and creating greater transparency around its finances. Amid this assessment process, it is unlikely that Omani government-related entities will be encouraged to increase their leverage. Dubai-based DP World sold \$1 billion in dual-tranche bonds in September 2020. However, its parent company, Dubai World, repaid \$8.2 billion in debt more than two years ahead of schedule, in an attempt to boost confidence in its debt management capabilities. Dubai World restructured \$23.5 billion in debt with its primary lenders following the 2008-09 global financial crisis.

Officials from Saudi Arabia's Public Investment Fund have considered bond issuances to raise investment capital; however, up to this point, the Saudi sovereign wealth fund has relied on other forms of borrowing, such as international syndicated loans and transfers from the country's central bank. In 2018, the Public Investment Fund completed an \$11 billion international syndicated loan facility as part of a "strategic, medium-term debt funding program,"⁶⁴ and the Public Investment Fund signed a \$10 billion syndicated bridge loan in October 2019.⁶⁵ The Saudi sovereign wealth fund is reportedly mulling an issuance of green bonds in the fourth quarter of 2021.⁶⁶ If the Public Investment Fund hopes to raise significant amounts of investment through conventional bond issuances, it will need to be more transparent concerning its total assets under management, governance structures, and investment strategy. The Public Investment Fund may be unwilling to disclose this information as long as other financing options are available.

⁶² "Oman's EDO Secures Debut \$2.5bn Financing Deal," *Argus Media*, August 15, 2021.

⁶³ "GCC GRE Debt Set to Continue Rising in 2021," *Fitch Ratings*, December 10, 2020.

⁶⁴ "Public Investment Fund Completes US\$11Billion International Syndicated Loan Facility," Public Investment Fund: Press Releases, September 16, 2018.

⁶⁵ "The Public Investment Fund Announces Signing a US\$10Billion Syndicated Bridge Loan," Public Investment Fund: Press Releases, October 29, 2019.

⁶⁶ "PIF Seeks to Issue First Green Bonds in Q4 2021: Report," *Argaam*, July 12, 2021.

The Path Ahead for Islamic Bonds and Maturities

While sovereign issuers often focus on conventional bonds because the market is bigger, Islamic bonds – financial certificates that comply with Islamic religious laws – are rapidly becoming an integral feature of regional bond dynamics. The number of Islamic bond issuances is expected to rise in the second half of 2021.⁶⁷ Sovereigns in stronger economic positions, such as Qatar, are likely to continue Islamic bond issuances to further develop the niche industry and enhance their respective positions as Islamic finance hubs. Moreover, the high demand for Islamic bonds combined with an underserved market means that Islamic bond issuances can be cheaper from a pricing perspective, increasing their attractiveness as cost-effective debt instruments for the Bahraini and Omani governments.

Debt instruments have a maturity date – thus short-term respites can return as longer-term headaches. The Omani government's external debt maturities are expected to average \$5.5 billion per year in 2021-22, before decreasing to \$3.6 billion annually for 2023-24, according to Fitch Ratings.⁶⁸ Bahrain's amortization schedule includes \$6.6 billion of external debt maturing between April and the end of 2024.⁶⁹ The Bahraini government will likely utilize the remaining portion of the \$10 billion GCC economic support package from 2018 to help fund these obligations. The Qatari government, which remains in a relatively strong financial position compared to neighboring countries, has had to contend with approximately \$4.1 billion of external debt maturities this year.⁷⁰

The bond rush of 2020-21 therefore may place sovereigns with weaker credit ratings, such as Oman and Bahrain, in a difficult position as debt matures concurrently and regional governments seek to refinance.

The prevalence of duplicate and overlapping economic policies and initiatives in the Gulf presents challenges

for governments with fewer financial resources. A similar dynamic plays out within debt markets because Gulf Arab sovereigns tend to issue bonds within similar time periods. The bond rush of 2020-21 therefore may place sovereigns with weaker credit ratings, such as Oman and Bahrain, in a difficult position as debt matures concurrently and regional governments seek to refinance. Countries with weaker credit ratings may have to pay even more to roll over bonds, providing additional justification for continued fiscal consolidation and debt reduction efforts.

Conclusion

Gulf Arab governments are in a stronger position to meet upcoming obligations or roll over debt than in 2020 for three primary reasons. First, higher oil prices and gradual production increases have greatly improved the state of government finances across the region. Second, it appears that governments have resisted the temptation to return to pre-pandemic spending

⁶⁷ "Global Sukuk Market Growth to Continue in 2021 and Beyond," *Fitch Ratings*, July 14, 2021.

⁶⁸ "Fitch Affirms Oman at 'BB-'; Negative Outlook," *Fitch Ratings*, May 18, 2021.

⁶⁹ "Fitch Affirms Bahrain at 'B'; Outlook Stable," *Fitch Ratings*, April 12, 2021.

⁷⁰ "Fitch Affirms Qatar at 'AA-'; Outlook Stable," *Fitch Ratings*, June 18, 2021.

patterns in the wake of rebounding oil prices. Though, year-end reporting and announcements for 2022 budgets will shed more light on regional commitments to fiscal consolidation. Third, a serious credit crisis in any GCC state would not advance the economic interests of fellow member states.

With the exceptional year of 2020 behind them, Gulf Arab policymakers are – in many respects – readjusting to more familiar modes of operating. Steady progress on fiscal consolidation, alongside higher oil prices and gradual production increases, has reduced external financing needs for the second half of 2021. Frenzied bond rushes have consequently devolved into processes of strategic financing, and the contours of such financing will continue to depend largely on domestic factors. Opportunistic bond issuances from sovereigns and corporates are likely to continue into 2022, but volumes will be more modest in most countries. If Kuwait's government and Parliament can agree on debt reform, long overdue Kuwaiti sovereign bonds have the potential to stir some excitement in debt markets.

