

Global Markets Research

Fixed Income

Monthly Perspective - Aug 2018

MYR Bond Market

Recapping the month of July

In the US, July saw lukewarm inflation readings despite decent US payrolls; causing **US Treasuries** (UST's) curve to shift higher as most tenors saw yields spike higher. However the Fed stayed pat on the Federal Fund Rates as at time of writing i.e. 2nd August; having hiked in June by 25bps to 1.75-2.00% range). The front-end rates i.e. 2Y UST spiked another 14bps higher at 2.67%. The dollar had generally ended mixed between -1.8% to +1.0% against G10 currencies in July with the Dollar Index maintaining at 94-95 levels; enabling investors to focus not only on the yield advantage the US enjoyed over some other countries. The 10Y, which depicts as a benchmark for US mortgage rates, borrowing costs for municipalities and also inflation indicator, oscillated between a low of 2.82% and a high of 2.99% levels before closing 11bps higher at 2.97% levels; due more to risk-on environment as global trade fears ebbed slightly. (Note that UST 10Y closed at 2.41% as at end-2017). The US yield curve reversed its narrowing trend the past months which were destined to be comparable to the lowest levels since 2007as the 2s10s spread moved wider from 25bps to 31bps whilst the 5s30s similarly moved from 20bps to 26bps.

On the local front, MYR bonds saw foreign holdings reverse the previous two (2) month's outflows on higher trade volume of RM72.0b versus RM42.6b the prior month. July saw foreign holdings increase RM4.0b m-o-m to RM189.8b, a refreshing note compared to June's outflows of RM6.7bn. The increase in foreign holdings of MYR government bonds led to a marginal uptick at 23.8% of total outstanding MYR Govvies consisting of MGS+GII+SPK. (June: RM168.3b or 23.7%). Corporate Bonds/Sukuk however saw a reduction of RM300m in the levels of foreign holdings at RM13.9b. Investors turned buyers with yields way lower especially for Govt-Guaranteed bonds as major revamp and reduction of major infrastructure projects amid further clarity on fiscal policies fell into place; post-GE14. Overall benchmark MGS/GII rallied with yields ending between 5-8bps lower across the flatter curve. The 7Y MGS 3/25 closed 9bps lower at 3.97% whilst the much-watched 10Y MGS 11/27 saw decent demand causing yields to fall 13bps at 4.07% levels.

MYR sovereign curve (MGS)



Source : Bloomberg



Headline NFP for July remained decent whilst wage gains held steady as unemployment rate edged lower....

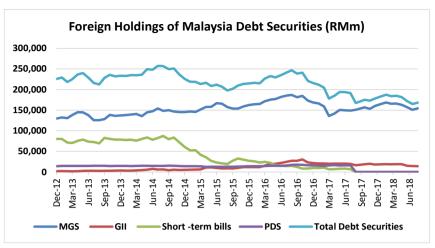
July Non-Farm Payrolls ("NFP") printed at 157k compared to market consensus of 193k. The previous month's reading of NFP was revised to 248k from the 213k registered initially. The unemployment rate fell one-tenth of a percentage point to 3.9% in July; as more people entered the labor force in a sign of confidence in their job prospects (It rose to 4.0% in June from an 18-year low of 3.8% in May). The slowdown in hiring last month is not the result of trade tensions, which have escalated of late but rather due to a shortage of workers. This is expected to push up wages; which has seen average hourly earnings rise 7 cents or 0.3% in July having gained 0.1% MOM in June. Hence annual increase in wages is now seen stabilizing at 2.7% YOY for July. The increase in wages is being closely monitored by the Fed for evidence of diminishing slack in the labor market and upward pressure on inflation. Despite the Fed staying pat in the first week of August; prospects of further interest rate increases in the US remain with near full-term employment are still seen over the horizon due to optimism over rising economic activity in the US.

The US central bank said "the labor market has continued to strengthen and economic activity has been rising at a strong rate". Its preferred inflation measure i.e. the PCE price index excluding the volatile food and energy components, increased by 1.9% in June. (Note that the core PCE hit Fed;s 2.0% target in March for the first time since December 2011). The tax reform-specific cuts which seem to push growth to an even faster pace and the Fed's balance sheet reduction/portfolio run-offs may lead to inflationary pressures and cause rates to rise faster than expected. Nevertheless, mitigating factors that may derail such moves are the impact arising from escalating trade tensions on the general well-being of the economy. Ultimately the Federal Reserve may have the last say interest rates may be hiked up to four (4) times in 2018; with the first two done.

Foreign Holdings of overall MYR bonds recovered from the low in June; buying seems to have resumed on cautious optimism...

Foreign holdings of MYR bonds bounced back in July following two consecutive down months with total holdings now up by RM4.0b or 2.2% to RM189.8b. The non-resident holdings of MGS similarly rose by RM5.0b to RM154.4b; representing 40.5% of total outstanding) whereas total MYR Govt bonds (i.e. MGS+GII+SPK) holdings saw an improvement of RM3.2b or 1.9% to RM168.3b (23.8% of total outstanding); from the lowest level of foreign holdings i.e. RM165.1b recorded in June since the beginning of the year.





Source: BNM, HLB Research

OPR maintained at 3.25% as emphasis was on policy normalization

BNM maintained the OPR at 3.25% at its recent MPC meeting on 11th of July (Note that the last hike was 25bps in January). The central bank has continued to strike a neutral tone stating that economic growth momentum will likely be sustained, underpinned by domestic and external demand, while inflation is forecast to be lower than initially projected. BNM's early rate hike move in January this year was seen as a pre-emptive move on normalization of policy rather than a tightening mode. There is belief that the central bank has flexibility to keep policy unchanged despite the recent emerging market sell-off that has somewhat caused recent outflows in Malaysia to the tune of RM27b in both bonds and equities since May 2018. Despite USDMYR upward move to average 4.05 in July, the MYR is one of the more resilient Asian currencies YTD, holding steady against USD; unlike the Peso, Rupee, Rupiah, Won and Baht. However general consensus on 2018 growth outlook remains steadfast with our house view pegged at 5.0% versus the annual report released in March by BNM; projecting GDP to expand 5.5-6.0%.



MYR government bond auctions saw strong support for the reopening of 7Y and 10Y govvies whilst the new 30Y MGS issuance notched a respectable BTC of 1.871x.....

MG	S/GII issuance pipeline in 2018													
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Total Expected Size (RM mil)	Auction Issuance (RM mil)	Private Placement	Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	20-yr Reopening of MGS (Mat on 04/37)	20	Jan	Q1	4/1/2017	3,000	2,000	1,000	2,000	1.905	4.573	4.607	4.640	14.3%
2	5-yr Reopening of MGII (Mat on 04/22)	5	Jan	Q1	12/1/2018	3,000	4,000		6,000	2.581	3.810	3.823	3.829	78.6%
3	15-yr Reopening of MGS (Mat on 04/33)	15	Jan	Q1	26/1/2018	3,000	2,500	1,000	8,500	2.474	4.415	4.446	4.455	1.7%
4	7.5-yr New Issue of MGII (Mat on 08/25)	7	Feb	Q1	6/2/2018	4,000	3,000	1,000	11,500	2.284	4.110	4.128	4.138	55.0%
5	10-yr Reopening of MGS (Mat on 11/27)	10	Feb	Q1	27/2/2018	3,000	3,500	500	15,000	2.066	4.036	4.055	4.064	90.0%
6	30-yr Reopening of MGII (Mat on 05/47)	30	Mar	Q1	8/3/2018	2,500	1,500	1,000	16,500	2.071	4.890	4.930	4.955	10.0%
7	7-yr New Issue of MGS (Mat on 03/25)	7	Mar	Q1	13/3/2018	4,000	3,000	1,000	19,500	2.347	3.870	3.882	3.889	67.7%
8	15-yr Reopening of MGII (Mat on 06/33)	15	Mar	Q1	22/3/2018	3,000	2,500	1,000	22,000	1.996	4.540	4.550	4.564	42.9%
9	3-yr Reopening of MGS (Mat on 11/21)	3	Mar	Q1	29/3/2018	3,500	3,000		25,000	1.722	3.439	3.451	3.464	80.0%
10	20-yr Reopening of MGII (Mat on 08/37)	20	Apr	Q2	12/4/2018	2,000	2,500		27,500	2.118	4.790	4.804	4.827	100.0%
11	5-yr New Issue of MGS (Mat on 04/23)	5	Apr	Q2	19/4/2018	4,000	4,000		31,500	1.563	3.728	3.757	3.780	8.8%
12	10.5-yr New Issue of MGII (Mat on 10/28)	10	Apr	Q2	27/4/2018	4,000	4,000		35,500	2.696	4.340	4.369	4.388	4.3%
13	15.5-yr New Issue of MGS (Mat on 11/33)	15	May	Q2	4/5/2018	4,000	3,000		38,500	2.722	4.620	4.642	4.653	66.0%
14	7-yr Reopening of MGII (Mat on 08/25)	7	May	Q2	14/5/2018	3,500	3,000		41,500	3.397	4.180	4.202	4.218	72.5%
15	10-yr Reopening of MGS (Mat on 06/28)	10	May	Q2	23/5/2018	3,500	3,500		45,000	1.851	4.178	4.202	4.215	45.5%
16	5.5-yr New Issue of MGII (Mat on 11/23)	5	May	Q2	30/5/2018	4,000	4,000		49,000	1.989	4.070	4.094	4.110	42.6%
17	20-yr New Issue of MGS (Mat on 06/38)	20	Jun	Q2	7/6/2018	3,000	2,500		51,500	1.942	4.866	4.893	4.906	23.3%
18	15-yr Reopening of MGII (Mat on 06/33)	15	Jun	Q2	28/6/2018	2,500	3,500		55,000	2.783	4.768	4.778	4.794	84.6%
19	30-yr New Issue of MGS (Mat on 07/48)	30	Jul	Q3	5/7/2018	3,000	2,000		57,000	1.871	4.890	4.921	4.949	33.9%
20	10-yr Reopening of MGII (Mat on 10/28)	10	Jul	Q3	13/7/2018	3,000	4,000		61,000	2.439	4.216	4.240	4.248	18.5%
21	7-yr Reopening of MGS (Mat on 03/25)	7	Jul	Q3	27/7/2018	3,500	3,000		64,000	3.302	3.970	3.984	3.990	22.5%
22	20-yr Reopening of MGII (Mat on 08/37)	20	Aug	Q3	6/8/2018	2,000	2,500		66,500	2.108	4.746	4.768	4.784	100.0%
23	15-yr Reopening of MGS (Mat on 11/33)	15	Aug	Q3		3,500								
24	5-yr Reopening of MGII (Mat on 11/23)	5	Aug	Q3		3,000								
25	30-yr Reopening of MGII (Mat on 05/7)	30	Sep	Q3		2,000								
26	10-yr Reopening of MGS (Mat on 06/28)	10	Sep	Q3		3,500								
27	3.5-yr New Issue of MGII (Mat on 03/22)	3	Sep	Q3		3,000								
28	20-yr Reopening of MGS (Mat on 06/38)	20	Oct	Q4		3,000								
29	10-yr Reopening of MGII (Mat on 10/28)	10	Oct	Q4		3,500								
30	7-yr Reopening of MGII (Mat 08/25)	7	Nov	Q4		3,000								
31	5-yr Reopening of MGS (Mat on 04/23)	5	Nov	Q4		3,000								
32	20-yr Reopening of MGII (Mat on 08/37)	20	Dec	Q4		2,000								
33	3-yr Reopening of MGII (Mat on 03/22)	3	Dec	Q4		2,000								
	Actual gross MGS/GII supp	ly in 2018				102,500	66,500	6,500						

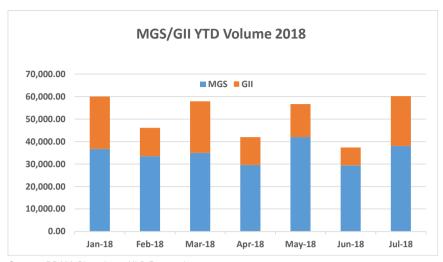
Source: BNM, HLB Research

The three (3) government bond tenders concluded for the month of July 2018 under the auction calendar included the new issuances of 30Y MGS 7/48, and the reopening of both the 7Y MGS 3/25 and 10Y GII 10/28, which altogether saw strong BTC support averaging 2.54x; better than the 2.43x for the two (2) auctions the prior month. (Compare this with the average BTC of 2.20x for the entire of 2017 consisting of 32 issuances in total and denotes a vast improvement also when compared to the YTD BTC of 2.30x for 2018). Tenders for the month were well received by both local and foreign institutional investors with some spillover interest from inter-bank players on the 7Y and 10Y space. Also worth noting was the latest 20Y auction/reopening of RM2.5b GII 8/37 recently on 6th August similarly notched a solid BTC of 2.108x averaging 4.768% somewhat similar to its prior auction in April this year.

Trading volume for MGS/GII spiked in July

Trading volume for MYR govvies gained traction as volume sky-rocketed from about RM37.2b in June to RM60.9b during June. The sharp increase was seen across the curve with substantial portion of trades seen in the short to mid-tenured off-the-run 18-19's, 21's, 23's and also both MGS and GII benchmarks 10Y bonds; both of which altogether topped frequency of trades for the month. Off-shore investors who were net sellers of Ringgit government bonds in May and June turned buyers in July on attractive valuations and further clarity by the Malaysian government on fiscal policies etc. despite slight narrowing of US-Asia interest rate differentials.

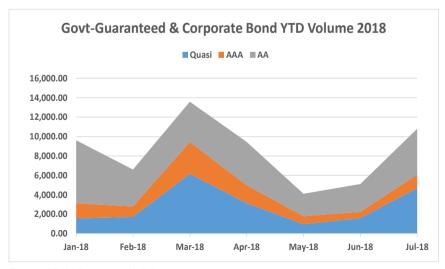




Source: BPAM, Bloomberg, HLB Research

Corporate bonds/sukuk interest was tepid nevertheless...

In the secondary market, the monthly trading volume for corporate bonds/sukuk (including Govt-Guaranteed bonds) continued to be active in July as volume jumped from RM5.4b in June to RM11.1b in July. Investors were skewed towards GG-segment of the curve @ 41% of total market share of trades (June: 30%); followed by the AArated space @ 39% market share of total trades (June: 51%) as investors chose credit and also yield-enhancing opportunities over Govvies. GG bonds were in demand due to the likelihood of Government's capping of further issuances due to the need to contain the overall contingent liabilities. Meanwhile volume on AAA-rated bonds were muted for the month under review. MAYBANK 68nc18 (AAA) and Sarawak Energy Berhad (SEB) 1/27 (AA3) topped the monthly volume; closing a whopping 17-35bps lower for the month. This was followed by DANAINFRA 4/25 (GG) and PLUS 32 (AAA) which closed 20bps and 7bps each. Appetite in the AA-space was seen in infrastructure-related bonds including power and toll sub-sectors i.e. SEB, JEP, SOUTHERN POWER, MALAKOFF, GAMUDA, MEX, SAMALAJU etc. For ease of reference we have excluded single-A rated and non-rated papers in the following illustration.



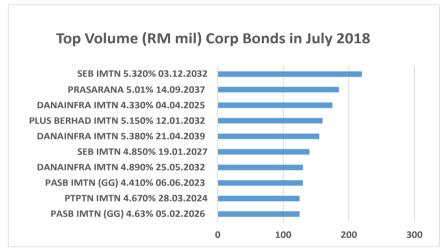
Source : BPAM, Bloomberg, HLB Research



Primary issuance print in July boosted by the following names:

Notable issuances in July-18	Rating	Amount Issued(RM mil)
Chellam Plantations (Sabah) Sdn Berhad	NR	6
Fenghuang Development Sdn Berhad	NR	23
GENM Capital Berhad	AAA	2,600
Hektar Black Sdn Berhad	NR	95
OSK I CM Sdn Berhad	NR	93
Scientex Quatari Sdn Berhad	NR	200
Sports Toto Malaysia Sdn Berhad	AA3	125
West Coast Expressway Sdn Berhad	NR	498
Kanger International Berhad	NR	2
Kuantan Port Consortium Sdn Berhad	NR	225
LBS Bina Holdings Sdn Berhad	NR	50
Public Islamic Bank Berhad	AAA	520
Sabah Development Bank Berhad	AA1	100
United Overseas Bank (Malaysia) Berhad	AA1	600
Eternal Icon Sdn Berhad	NR	16
Senari Synergy Ventures Sdn Berhad	NR	240
Affin Bank Berhad	A3	500
		5,892

Source: Bloomberg, BPAM, HLB Research



Source: Bloomberg, BPAM, HLB Research

Outlook for August

Government has addressed fiscal policy concerns but headwinds may persist due to global trade spat...

As accurately projected earlier month, we continue to expect liquidity to sustain for local govvies as investors warm-up to the new government's initiatives. Values seen emerging in the 15-20Y space are being nibbled at by both local and offshore demand. Demand for Ringgit Corporate Bonds/Sukuk is expected to be robust as was the case for the past two (2) months as investors put aside looming credit concerns over infrarelated projects i.e. tolled-highways, power-plants etc. We foresee demand for Government-Guaranteed (GG) bonds in view of potential lack of supply going forward and positive yield-carry requirements.

The decent BTC for the three (3) auctions in July averaging 2.54x is marginally higher than the 2.43x for all auctions the previous month; yet strong compared to the average



BTC of 2.20x for the entire of 2017. We continue to maintain our view of benign inflationary outlook this year coupled with moderating growth will enable BNM to keep OPR unchanged for the rest of the year as other countries normalize.

The Ringgit is seen to improve from current levels from the recent and ongoing "relief rally" arising from transparency and clarification of fiscal policies although some weakness is anticipated from emerging economies including South-East Asian economies. The government has announced several strong measures to minimize the net federal deficit which is projected to marginally increase from RM39.8b to RM40.1b; maintaining the fiscal deficit at ~2.8%. Some of these include the downsizing and potential halting of mega-infra projects like the ECRL, HSR, MRT3 whilst stemming the pilferage and expenditures by government agencies etc. The replacement of GST with SST is expected to stem the deficit whist recovery processes from 1MDB's forays are concluded. The outflows from emerging markets in the past couple of months due to tightening interest rate differential compared with US has reversed for Malaysia as evident from the recent foreign holdings data for July 2018. The flip-side to these would be the potential impact on trade balances arising from the long-drawn "global trade war" engaged by both US and China.

Fed dot plot implies 2 additional Fed rate hikes for 2018 whilst the Overnight Index Swaps are pricing in ~ 1.5 instead...

The recent movement of US Treasury yields in July saw the curve reversing slightly its earlier flattening mode with the 2s10s and 5s30s spreads gapping wider prior month. With the economy accelerating with direct implications on wage-cost pressures and interest rate policy mentioned above; the tilt to a hawkish shift leaning to four (4) and not three (3) rate hikes in total for 2018 can be only derailed by the ugly impact of tit-for-tat trade barriers and tariffs. The U.S. Treasury Department will raise the amount of long-term debt it sells to \$78 billion this quarter while launching a new two-month bill. It also will lean more heavily on maturities out to five years. In its quarterly refunding announcement on Wednesday, the Treasury boosted the auction sizes of coupon-bearing and floating-rate debt from \$73 billion the previous quarter. It was the third consecutive quarterly increase, as President Donald Trump's fiscal policies widen the nation's budget deficit and cause further issuances by the Treasury to fund the deficit arising from the imposition of the Tax budget and additional government spending. Nevertheless the possibility of portfolio capital inflows from global lifers and pension funds will be forthcoming as yields become attractive.

The UST 10Y which stayed below 3.00% in July (currently at 2.99% levels at the time of writing) crossed the 3.00% resistance again on 1st of August (previous high of 3.11% on 13th June) due to interest rate hike fears but eased back over excessive fears on the negative impact on global trade barrier issues. Expect UST 10Y to maintain and oscillate between the 2.90-3.10% levels for August. Flattening of the yield curve is expected to continue as economy may be showing signs of under-estimation in inflation. Negative-duration portfolios are expected to be adopted by fund managers as investors switch asset classes on risk-on versus risk-off mode.

In the Corporate space, investors are again encouraged to switch towards Investment Grade issuances instead of High Yield ones as companies with strong balance sheets and lower level of debts will be able to weather the storm with regards to the impact of rising rates and trade sputters.



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