October 10, 2018

Global Markets Research

Fixed Income

Monthly Perspective – Oct 2018

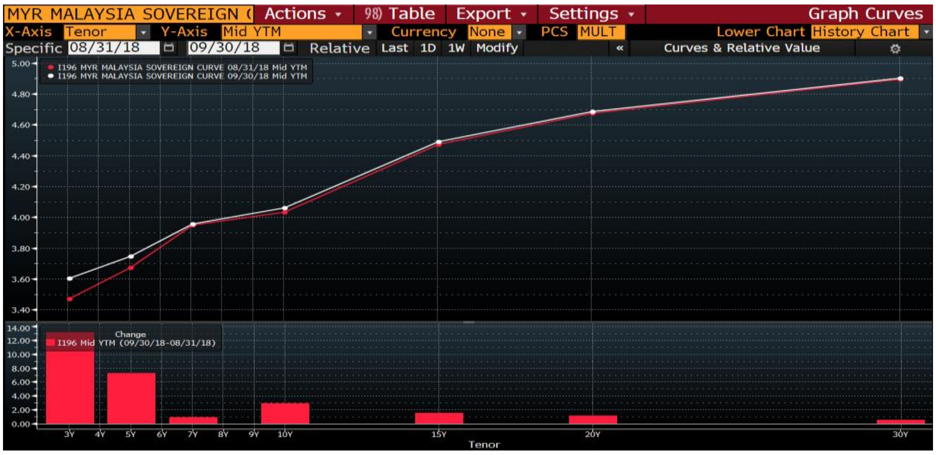
MYR Bond Market

Recapping the month of September

The US continued to see steady payrolls in September despite setback from Hurricane Florence; causing US Treasuries (UST's) curve to shift higher as losses were seen across most tenures; amid strong economic data and equity markets and also heavy corporate bond issuance following the tepid summer period. Most tenors saw yields spike between 19-21bps. The Fed raised the Federal Fund Rates by another 25bps on 26th September, the 3rd time this year and reiterated that further gradual increases will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2% objective over the medium term. The front-end rates i.e. 2Y UST skied by 19bps at 2.82% levels; highest levels since 2008. The dollar had generally ended mixed between -0.35% to +0.60% against most G10 currencies in September with the Dollar Index anchored at 94-95 levels. The 10Y, which depicts as a benchmark for US mortgage rates, borrowing costs for municipalities and also inflation indicator, oscillated wider between a low of 2.86% and a high of 3.10% levels before closing a whopping 20bps higher MOM at 3.06% levels (last seen in May) as risk-off mode waned with the signing of NAFTA global trade agreement. The US yield curve saw little changes, as the 2s10s spread was maintained at 23bps whilst the 5s30s similarly saw a 3bps move lower to 33bps, but still holding above multi-year lows last reached in July.

On the local front, ***MYR bonds*** *saw continued reduction in foreign holdings for the 2nd month running following a respite in July on slowing momentum and lower trade volume of RM63.2b versus RM73.9b the prior month. September saw foreign holdings decrease RM3.0b MOM to RM184.5b, compared to July's refreshing inflows of RM4.0bn. The percentage of foreign holdings of MYR government bonds eased to 23.2% of total outstanding MYR Govvies consisting of MGS+GII+SPK. (Aug: RM167.1b or 23.7%). Overall benchmark MGS/GII bonds weakened with yields rising between 2-13bps across a flatter curve on the front-end. The 7Y MGS 3/25 edged 2bps higher at 3.95% whilst the much-watched 10Y MGS 6/28 saw decent volume causing yields to rise 3bps at 4.07% levels. Corporate Bonds/Sukuk however saw a mild reduction of RM161m in the levels of foreign holdings at RM13.2b. Investors turned buyers as bonds rallied causing yields to end lower for Corporate Bonds/Sukuk with confidence returning upon clarification on fiscal policies and reassessment of mega-infrastructure projects.*

MYR sovereign curve (MGS)



Source : Bloomberg

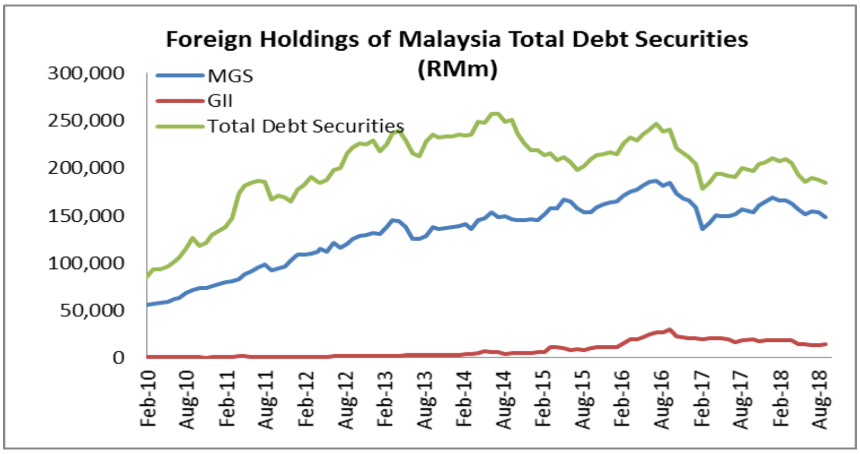
Headline NFP for September eased; wage gains were sustained whilst unemployment rate dipped again….

September Non-Farm Payrolls ("NFP") printed 134k compared to market consensus of 185k as Hurricane Florence has had a notable impact on the September jobs report. There was however an upward revision of 87k for past two (2) months i.e. July and August which is deemed to offset September's weakness. The unemployment rate of 3.7% turned out to be the lowest ever since 1969 (Aug: 3.9%); denoting sign of confidence in current job prospects which is expected to push up wages. This was evident in the sustained average hourly earnings growth of 0.3% MOM in September. 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. (Economists tend to link an increase of 3.0% with rising inflation). With the Fed raising interest rates to between 2.00-2.25% in the last week of September coupled with the robust market-moving ISM data on Non-Manufacturing employment; this has cemented expectations of a 4th and final interest rate increase when policy-makers meet in December 2018.

The US central bank said that "further gradual increases in the Target range for the federal funds rate will be consistent with sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2% objective over the medium term. Labor market has continued to strengthen and economic activity has been rising at a strong rate". Its preferred inflation measure i.e. the core PCE, increased by 2.0% YOY in August. (Note that the core PCE hit Fed's 2.0% target in March for the first time since December 2011). However the latest CPI reading for September due on Thursday, the 11th of November would reveal the extent of the impact on inflation. Nevertheless, the tax reform-specific cuts which has helped accelerate economic growth and the Fed's balance sheet reduction/run-offs may lead to inflationary pressures and cause rates to rise faster than expected. Mitigating factors that may derail the rate hike path is the impact arising from escalating US-China trade tensions.

Foreign Holdings of overall MYR bonds dipped again in September following a brief recovery in July amid cautious trades following recent rout in emerging market financial markets…

Foreign holdings of MYR bonds continued to fall in September with total holdings reducing by RM3.0b or 1.6% to RM184.5b. The non-resident holdings of MGS dropped substantially by RM5.6b to RM148.3b; representing 39.5% of total outstanding) whereas total MYR Govt bonds (i.e. MGS+GII+SPK) holdings also saw slight pull-back of RM4.4b or 2.7% to RM162.7b (23.2% of total outstanding); the lowest level of foreign holdings for the year and also since April 2017 last year.



Source: BNM, HLB Research

OPR maintained at 3.25% as concern were on global trade tensions

BNM maintained the OPR at 3.25% at its recent MPC meeting on 5th of September (Note that the last hike was 25bps in January) amid low inflation and tempered economic growth expectations for the year. The central bank reiterated that "the economy faces downside risks stemming from heightened trade tensions, prolonged weakness in the mining and agriculture sectors and some domestic policy uncertainty. On balance, the Malaysian economy is expected to remain on a steady growth path." However despite the recent emerging market sell-off caused by the contagion from Turkey, India and right up to Indonesia commencing August onwards has somewhat seen resumption of slight outflows from Malaysia following earlier ones post GE14 in May this year resulting in net outflows of RM33b since then. The USDMYR further weakened to average 4.1380 levels as at end-September (4.1550 levels at time of writing) but ultimately more resilient YTD than most Asian currencies like Rupiah, Rupee, Peso and the Japanese Yen. 2018 growth outlook remains steadfast with our house view pegged at 4.4% whilst BNM has similarly revised its projection of GDP from 5.5-6.0% to 5.0%.

MYR government bond auctions saw solid support for the reopening of 30Y, 10Y govvies. 3Y GII new issuance notched BTC of 2.217x on local inter-bank player support…..

MGS/GII issuance pipeline in 2018

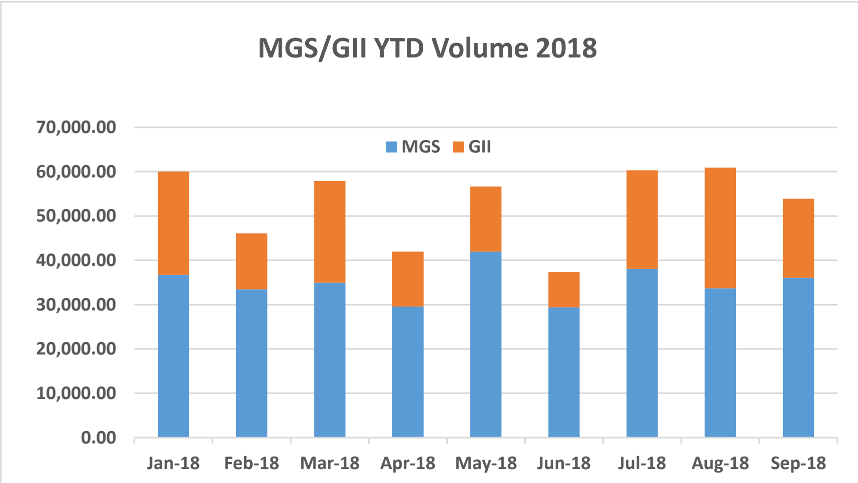
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Total Expected Size (RM mil)	Auction Issuance (RM mil)	Private Placement	Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	20-yr Reopening of MGS (Mat on 04/37)	20	Jan	Q1	4/1/2017	3,000	2,000	1,000	2,000	1.905	4.573	4.607	4.640	14.3%
2	5-yr Reopening 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	14/8/2018	3,500	3,000		69,500	2.612	4.480	4.498	4.506	85.3%
24	5-yr Reopening of MGII (Mat on 11/23)	5	Aug	Q3	29/8/2018	3,000	3,500		73,000	1.817	3.800	3.816	3.825	50.0%
25	30-yr Reopening of MGII (Mat on 05/47)	30	Sep	Q3	13/9/2018	2,000	2,000		75,000	1.935	4.932	4.973	4.992	90.0%
26	10-yr Reopening of MGS (Mat on 06/28)	10	Sep	Q3	20/9/2018	3,500	3,000		78,000	2.670	4.080	4.097	4.100	54.8%
27	3.5-yr New Issue of MGII (Mat on 03/22)	3	Sep	Q3	27/9/2018	3,000	3,000		81,000	2.217	3.717	3.729	3.745	43.6%
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								
	Gross MGS/GII supply in 2018					102,500	81,000	6,500						

Source: BNM, HLB Research

The three (3) government bond tenders concluded for the month of Sep 2018 under the auction calendar included the reopening of the longer-tenured 30Y GII 5/47, 10Y MGS 6/28 along with the new issuance of 3Y GII 3/22. These altogether saw a higher BTC support averaging 2.32x; versus 2.16x for the three (3) auctions the prior month i.e. in August. (Compare this with the average BTC of 2.20x for the entire of 2017 consisting of 32 issuances in total and also to the YTD BTC of 2.29x for 2018). Tenders for the month were initially well-received by both local and foreign institutional investors including the long 30Y GII 5/47 which still garnered a better BTC ratio of 1.935x; albeit slightly lower than its recent opening in March (BTC: 2.07x) due to lack of appetite compared to other tenures.

Lower trading volume for MGS/GII in September

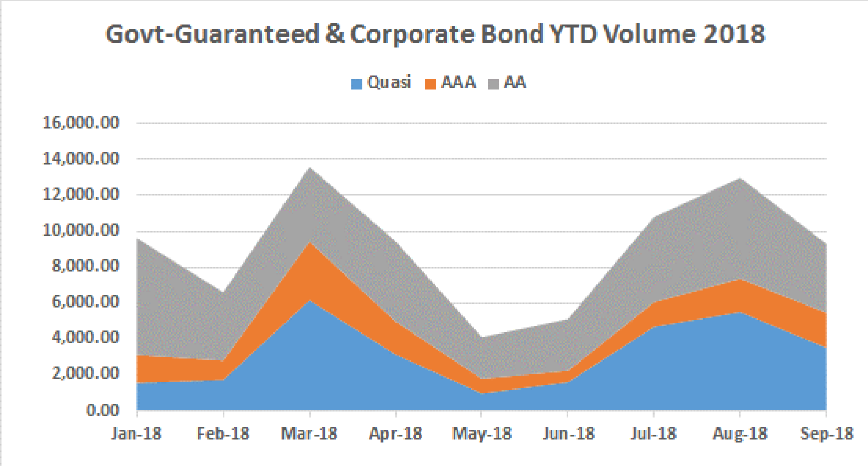
Trading volume for MYR govvies maintained traction with volume at about RM54.1b in September compared to RM62.4b in August. Interest was seen across the curve with substantial portion of trades and nominal amounts seen in the short to mid-tenured off-the-run 18-19's, 21-23's and also both MGS and GII benchmarks 10Y bonds which formed almost 10% of total volume for the month under review. Off-shore investors who turned buyers in July on attractive valuations and further clarity by the Malaysian government on fiscal policies turned cautious with net selling activities for the month under review on EM market contagion arising from higher US interest rate outlook.



Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk interest was strong…

In the secondary market, Corporate bonds/Sukuk (including Govt-Guaranteed bonds) continued to be active despite lower monthly trading volume i.e. from RM13.5b in August to RM9.5b in September. This was partly due to concerns over ongoing EM outflows and lower staffing levels due to additional holidays in September. Investor appetite for AAA-rated bonds improved to 21% of overall trades whilst the GG and AA-part of the curve saw continued interest albeit on lower nominal amounts ~ 38% and 41% respectively of total market share of trades which displayed similar pattern in the prior month of August as investors maintained the hunt for credit and yield-enhancing papers over Govvies. GG bonds continued to be in demand due to the sparse issuances post GE 14 in May as the newly-elected government reigns in the nation's overall contingent liabilities. The government-guaranteed PRASARANA 9/24 and short-tenured AAA-rated DANGA 4/20 topped the monthly volume; closing a whopping 13-16bps lower for the month compared to previous-done levels. This was followed by both DANAINFRA 5/23 (GG) and DANAINFRA 4/21 (GG) which closed mixed between -6 and +1bps respectively. Appetite in the credit space was also seen in infrastructure-related bonds including power and toll sub-sectors i.e. AA-rated Jimah Energy Power, Sarawak Energy Berhad 19-29, Southern Power Group 22-35, LDF3 (DUKE3) 29-38 and also AAA-rated DANGA 20-33, CELCOM 19-26, RANTAU 20-29 and TENAGA 32-38. We have excluded single-A rated and non-rated papers in the illustration below.

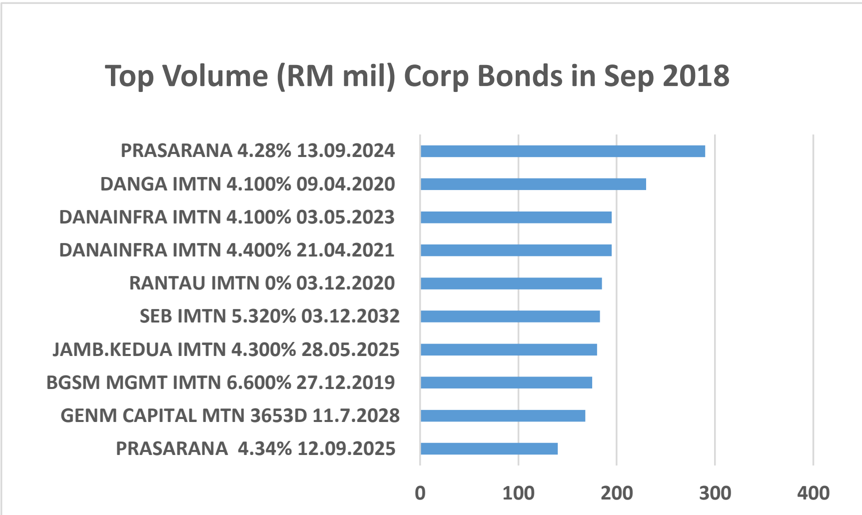


Source : BPAM, Bloomberg, HLB Research

Primary issuance print in September boosted by following names:

Notable issuances in Sep-18	Rating	Amount Issued (RM mil)
BGSM Management Sdn Berhad	AA3	200
Cagamas Berhad	AAA	600
CIMB Group Holdings Berhad	AA2	1,200
CIMB Bank Berhad	AA2	1,200
Eden Inc. Berhad	NR	3
Fenghuang Development Sdn Berhad	NR	29
Fortune Premiere Sdn Berhad	AA2	1,200
Hap Seng Management Sdn Berhad	NR	300
Hong Leong Financial Group Berhad	AA1	400
Kenanga Investment Bank Berhad	NR	10
Liziz Standaco Sdn Berhad	NR	19
Magnum Corporation Sdn Berhad	NR	215
Prasarana Malaysia Berhad	GG	1,000
Sabah Credit Corporation	AA1	890
Southkey Megamall Sdn Berhad	NR	50
Sports Toto Malaysia Sdn Berhad	AA3	30
Uzma Integrasi Padu Berhad	NR	250
UMW Holdings Berhad	AA2	200
		7,346

Source : Bloomberg, BPAM, HLB Research



Source : Bloomberg, BPAM, HLB Research

Outlook for October

Government prudent on fiscal policies but headwinds may persist due to EM outflows, ongoing global trade disputes and higher US rate outlook….

The decent BTC for the three (3) auctions in September averaging 2.32x is testimony to the depth of the local govvies market when compared to the average BTC of 2.20x for the entire of 2017. Attractive valuations are seen emerging whist catering to the liquidity requirements of institutional investors and inter-bank players alike. We continue to maintain our view that mild inflationary outlook this year (removal of GST and reintroduction of petrol subsidy for RON 95 and diesel) coupled with moderating growth will enable BNM to keep OPR unchanged for the rest of the year barring the contagion effects of EM outflows as was the case with Argentina, Brazil, Turkey, India and recently Indonesia.

The Ringgit is seen to be flexible and stabilize at current levels as the government has announced strong measures to minimize the net federal deficit which is projected to marginally increase from RM39.8b to RM40.1b; thus maintaining the fiscal deficit at ~2.8% of GDP. Some of these include the review of mega-infra projects like the ECRL, HSR, MRT3, Pan-Borneo highway and gas-pipeline projects whilst stemming the pilferage and expenditures by government agencies. Potential new taxes may be announced in the upcoming budget scheduled for 2nd November to address the fiscal deficit, in addition to asset sales to increase revenue of the Federal Government. The outflows from EM's in the past couple of months due to tightening interest rate differential with the US still remains a concern somewhat for Malaysia as evident in the continued reduction in foreign holdings for Malaysian debt securities for August and September 2018. Like-wise, ongoing global trade issues mainly between US and China continues may dampen appetite and necessitate a fight-to-safety for UST's. Another notable concern is the potential outflows due to net difference of RM10.5b of govvies maturities in October versus the projected issuances of RM6.5b.

Based on the above concerns, we expect a relatively quiet October despite sufficient liquidity. **Values are seen emerging in the 7Y and also the 15Y space along with off-the-run GII bonds i.e. 22-25's which display decent premiums. Demand for Ringgit Corporate Bonds/Sukuk along the GG and AA-segment is expected to be robust as was the case for the past three (3) months as investors cast aside looming credit concerns over deferment of large infra-related projects i.e. tolled-highways, power-plants. Continued demand for Government-Guaranteed (GG) bonds is envisaged** in view of a dearth of fresh supply going forward and positive yield-carry of ~25-35bps over similar-tenured MGS.

Fed dot plot implies an additional Fed rate hike for 2018 making it a total of 4 for the year…

The recent movement of US Treasury yields in September saw the curve move lower and resume its earlier flattening bias with the 2s10s and 5s30s spreads off-July lows. With the economy accelerating with direct implications on wage-cost pressures and interest rate policy mentioned above; the hawkish tilt leaning to four (4) and not three (3) rate hikes in total for 2018 looks real. The economy may be shielded from the trade tensions by the $1.5 trillion tax cut package and increased government spending. However the continued swelling of debt issuance by the U.S. Treasury Department has also seen recent BTC ratios weaken at higher average yields. Separately, central banks, lifers and pension funds are expected to back-up demand especially on the longer-end.

The UST 10Y which trended well below 3.00% threshold in August save for a brief period early in the month has breached those levels (Note: previous high of 3.11% on 13th June) and is expected to test the 3.30% levels in October on strong US data. Expect another hike in the upcoming FOMC on 19th December amid strong economic data. **Expect UST 10Y to maintain and oscillate between the 3.10-3.30% levels for October as traders reduce short positions**. The current yield curve is expected to maintain a flattened-bias unless the economy shows signs of under-estimation in inflation. The downside risks to the above assumptions are the negative impact on global trade barrier issues especially pertaining to US-China and emergence of geo-political issues (if any). **Short to intermediate duration portfolios may garner interest** (i.e. 2-5 years). **In the Corporate space, investors are expected to be rewarded in Investment Grade issuances** instead of High Yield with positive returns, as these corporates are better-equipped to weather the test of global trade uncertainties amid better funding opportunities.

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