

Global Markets Research

Fixed Income

Monthly Perspective – Sep 2018

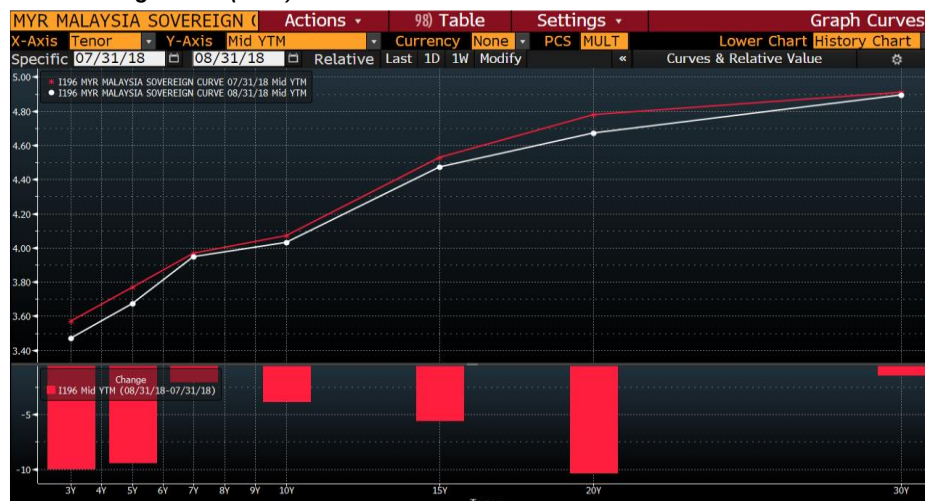
MYR Bond Market

Recapping the month of August

In the US, August saw lukewarm inflation readings despite solid US payrolls; causing **US Treasuries** (UST's) curve to shift lower. With the exception of the long-bond; most tenors saw yields 4-10bps lower. With the Fed staying pat on the Federal Fund Rates on 2nd August; the recent minutes revealed a gradualist approach to interest-rate increases with hints that growth could slow in the 2nd half of the year. The front-end rates i.e. 2Y UST was stable, edging 2bps lower at 2.65% levels. The dollar had generally ended stronger between 0.5-3.8% against most G10 currencies in August with the Dollar Index marginally stronger from 94.7 to 95.1 levels. The 10Y, which depicts as a benchmark for US mortgage rates, borrowing costs for municipalities and also inflation indicator, oscillated between a low of 2.81% and a high of 3.00% levels before reversing prior month's 11bps move back to 2.85% levels; as risk-of node took cognizance amid re-emergence of global trade fears. (UST 10Y settled at 2.41% as at end-2017). The US yield curve resumed its narrowing trend the past months which were destined to be comparable to the lowest levels since 2007 as the 2s10s spread tightened from 28bps to 20bps whilst the 5s30s saw a mere 1bps move lower to 25bps (July:26bps).

On the local front, **MYR bonds** saw foreign holdings resume outflows similar during May-June period (following a respite in July) on strong momentum and higher trade volume of RM62.4.0b versus RM60.9b the prior month. August saw foreign holdings decrease RM2.4b MOM to RM187.4b, compared to June's refreshing inflows of RM4.0bn. The marginal decrease in foreign holdings of MYR government bonds saw the percentage ease to 23.7% of total outstanding MYR Govvies consisting of MGS+GII+SPK. (July: RM168.3b or 23.8%). Corporate Bonds/Sukuk however saw a reduction of RM567m in the levels of foreign holdings at RM13.3b. Investors turned buyers as bonds rallied causing yields to end lower for both Govvies and Corporate Bonds/Sukuk with confidence slowly returning upon further clarity on fiscal policies and revamp of previous government's policies and projects. Overall benchmark MGS/GII bonds rallied again between 3-11bps lower across a flatter curve. The 7Y MGS 3/25 closed 3bps lower at 3.93% whilst the much-watched 10Y MGS 6/28 saw decent demand causing yields to fall 4bps at 4.03% levels.

MYR sovereign curve (MGS)



Source : Bloomberg

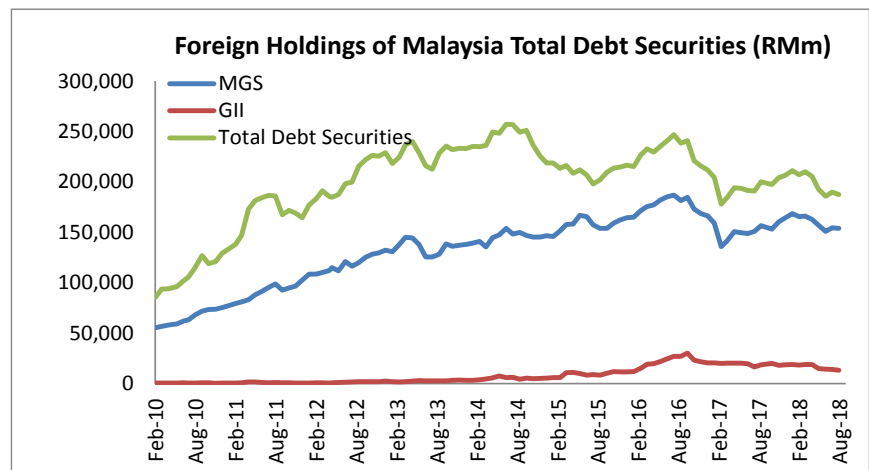
Headline NFP for August surged; wage gains improved yet unemployment rate holds steady....

August Non-Farm Payrolls (“NFP”) printed at 201k compared to market consensus of 191k. The previous month’s reading of NFP was revised to 147k from the 157k registered initially; with net 2-month revision (June and July) portraying a not-so-robust picture based on revised 50k lower. The unemployment rate was unchanged at 3.9% in Aug; denoting sign of confidence in current job prospects which is expected to push up wages. This was evident as seen in the average hourly earnings rise of 10 cents or 0.4% in August; having gained 7 cents or 0.3% M-O-M in July. Hence annual increase in wages is now seen stabilizing at a solid 2.9% Y-O-Y for August; the largest since June 2009. 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). Despite the Fed staying pat in the first week of August; the report cemented expectations of a 3rd interest rate increase from the Fed this year when policy makers meet on 25-26th of September this month.

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; a lagging indicator excluding the volatile food and energy components, increased by 2.0% in July. (Note that the core PCE hit Fed’s 2.0% target in March for the first time since December 2011). However the latest CPI Y-o-Y data for August reveals a pullback to 2.7% from prior month’s 2.9%. 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. Mitigating factors that may derail hikes is the impact arising from escalating trade tensions. Ultimately the Federal Reserve may have the last say if interest rates may be hiked up to four (4) times in 2018; with the first two done in March and June.

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

Foreign holdings of MYR fell back in August following an uptick the earlier month with total holdings now lesser by RM2.4b or 1.3% to RM187.4b. The non-resident holdings of MGS dropped marginally by RM560m to RM153.9b; representing 40.0% of total outstanding) whereas total MYR Govt bonds (i.e. MGS+GII+SPK) holdings also saw slight pull-back of RM1.2b or 0.7% to RM167.1b (23.7% of total outstanding); off the lowest level of foreign holdings i.e. RM165.1b recorded in June since the beginning of this 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) on the back of low inflation and tempered economic growth expectations for the year. The central bank has continued stated that the economy faces downside risks stemming from heightened trade tensions, prolonged weakness in the mining and agriculture sectors and some domestic policy uncertainty and on balance, the Malaysian economy is expected to remain on a steady growth path. 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 move. However despite some stability in July, the recent emerging market sell-off caused by the contagion from Turkey 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 amounting to RM27b then. The USDMYR weakened to average 4.1090 levels as at end-August (4.14 levels at time of writing) but ultimately more resilient YTD than certain Asian currencies like Rupiah, Rupee, Peso and the South Korean Won. 2018 growth outlook remains steadfast with our house view pegged at 4.5% 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 15Y, 20Y govies whilst the 5Y GII reopening notched lower BTC of 1.817x 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-00	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)	05-Jan-00	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-00	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)	07-Jan-00	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-Jan-00	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-Jan-00	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)	07-Jan-00	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-Jan-00	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)	03-Jan-00	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-Jan-00	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)	05-Jan-00	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-Jan-00	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-Jan-00	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)	07-Jan-00	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-Jan-00	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)	05-Jan-00	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-Jan-00	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-Jan-00	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-Jan-00	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-Jan-00	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)	07-Jan-00	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-Jan-00	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-Jan-00	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)	05-Jan-00	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-Jan-00	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-Jan-00	Sep	Q3		3,500								
27	3.5-yr New Issue of MGII (Mat on 03/22)	03-Jan-00	Sep	Q3		3,000								
28	20-yr Reopening of MGS (Mat on 06/38)	20-Jan-00	Oct	Q4		3,000								
29	10-yr Reopening of MGII (Mat on 10/28)	10-Jan-00	Oct	Q4		3,500								
30	7-yr Reopening of MGII (Mat on 08/25)	07-Jan-00	Nov	Q4		3,000								
31	5-yr Reopening of MGS (Mat on 04/23)	05-Jan-00	Nov	Q4		3,000								
32	20-yr Reopening of MGII (Mat on 08/37)	20-Jan-00	Dec	Q4		2,000								
33	3-yr Reopening of MGII (Mat on 03/22)	03-Jan-00	Dec	Q4		2,000								
Gross MGS/GII supply in 2018						102,500	75,000	6,500						

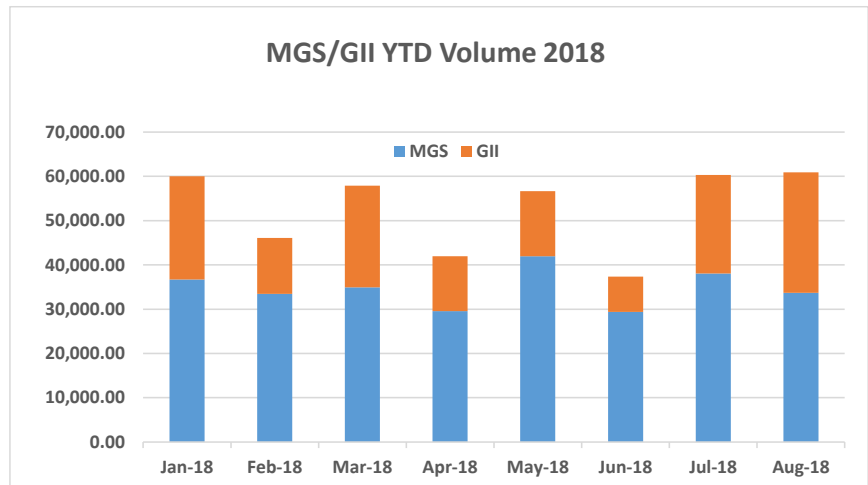
Source: BNM, HLB Research

The three (3) government bond tenders concluded for the month of Aug 2018 under the auction calendar included the reopening of the longer-tenured 20Y GII 8/37, 15YMGs along with the 5Y GII 11/23. These altogether saw a lower BTC support averaging 2.18x; versus 2.54x for the three (3) auctions the prior month i.e. in July. (Comparable with the average BTC of 2.20x for the entire of 2017 consisting of 32 issuances in total but denotes a slight lag when compared to the YTD BTC of 2.28x for 2018). Tenders for the month were initially well-received by both local and foreign institutional investors save for the 5Y GII 11/23 as contagion from EM affected inflows as the month progressed.

Also worth noting is the latest 30Y auction/reopening of RM2.0b GII 5/47 as at the time of writing notched a decent BTC of 1.935x averaging 4.973%; albeit lower than its prior auction in March this year @ 2.071x

Trading volume for MGS/GII maintained in August

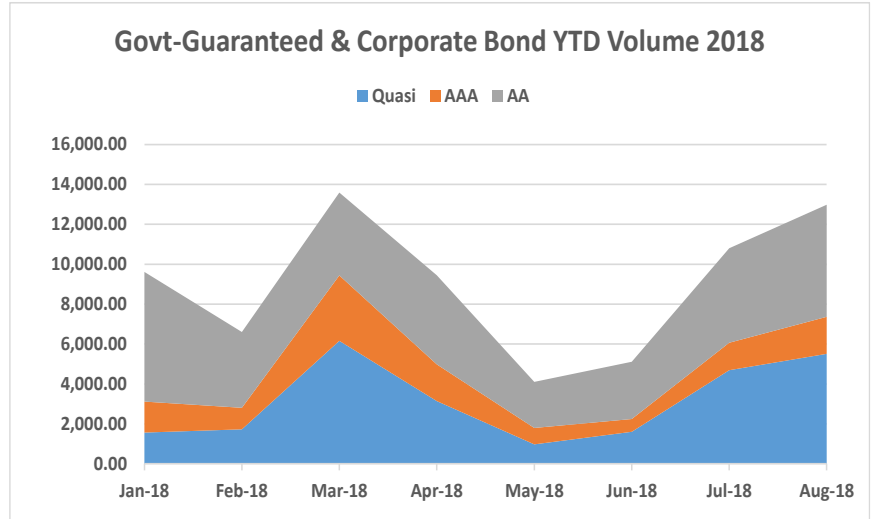
Trading volume for MYR govies maintained traction with volume at about RM62.4b in August compared to RM60.9b in July. Interest was seen across the curve with substantial portion of trades seen in the short to mid-tenured off-the-run 19’s and 23’s and also both MGS and GII benchmarks 10Y bonds whilst topping the frequency of trades for the month as well. 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 noted for the month under review on EM market contagion.



Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk interest was strong...

In the secondary market, the monthly trading volume for corporate bonds/sukuk (including Govt-Guaranteed bonds) continued to be active in August as volume jumped from RM11.1b in July to RM13.5b in August. Investors were still skewed equally between both the GG and AA-segment of the curve; forming ~ 43% each of total market share of trades which were similar to the prior month i.e. July as investors maintained the hunt for credit and yield-enhancing papers 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 nation’s overall contingent liabilities. AAA-rated CAGAMAS 2/19 and the longer-tenured Govt-guaranteed MKD Kenchana 10/32 topped the monthly volume; closing a whopping 7-13bps lower for the month. This was followed by DANAINFRA 8/23 (GG) and Jambatan Kedua Sdn Bhd (GG) 5/25 which closed 2bps lower respectively. Appetite in the credit space was seen in infrastructure-related bonds including power and toll sub-sectors i.e. JEP, KESTURI 21-32’s and also AAA-rated DANGA and PLUS 21-33’s. For ease of reference we have excluded single-A rated and non-rated papers in the illustration below.

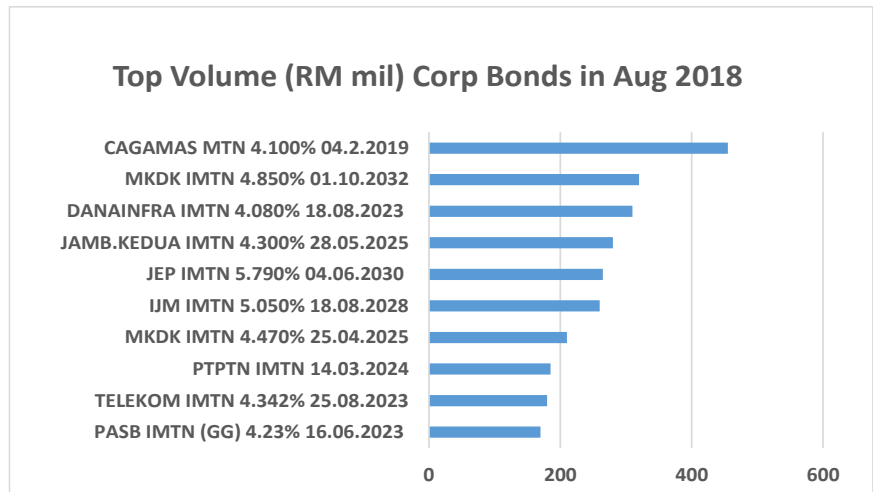


Source : BPAM, Bloomberg, HLB Research

Primary issuance print in August boosted by the following names:

Notable issuances in Aug-18	Rating	Amount Issued(RM mil)
ALSREIT Capital Sdn Berhad	NR	163
Boustead Holdings Berhad	NR	200
Bandar Serai Development Sdn Berhad	AA3	100
Cagamas Berhad	AAA	25
DanaInfra Nasional Berhad	GG	1,400
Fenghuang Development Sdn Berhad	NR	21
Hap Seng Management Sdn Berhad	NR	290
IJM Corporation Berhad	AA3	200
LBS Bina Holdings Sdn Berhad	NR	17
Public Holdings Sdn Berhad	NR	474
Perbadanan Kemajuan Negeri Selangor	AA3	300
Sabah Development Bank Berhad	AA1	75
Telekom Malaysia Berhad	AAA	250
Tenaga Nasional Berhad	AAA	3,000
TRIpIc Medical Sdn Berhad	NR	40
YTL Power International Berhad	AA1	1,000
		7,555

Source : Bloomberg, BPAM, HLB Research



Source : Bloomberg, BPAM, HLB Research

Outlook for September

Government prudent on fiscal policies but headwinds may persist due to EM outflows and ongoing global trade rumblings....

Despite the above concerns, we continue to expect liquidity to sustain for local govvnies as investors praise the new government's initiatives. Values are still seen emerging in the 7Y and also the 15-20Y space along with the 22-23's off-the-runs which display decent premiums. Demand for Ringgit Corporate Bonds/Sukuk is expected to be robust as was the case for the past two (2) months as investors cast aside looming credit concerns over deferment of large infra-related projects i.e. tolled-highways, power-plants etc that may require funding via government-guarantees. Hence we foresee demand for Government-Guaranteed (GG) bonds in view of potential lack of supply going forward and positive yield-enhancements over similar-tenured govvnies.

The decent BTC for the three (3) auctions in Aug averaging 2.18x is marginally lower than the 2.54x for all auctions the previous month; yet almost similar compared to the average BTC of 2.20x for the entire of 2017. We continue to maintain our view that benign inflationary outlook this year 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 is the case with Argentina, Brazil, Turkey, India and recently Indonesia

The Ringgit is seen to 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 downsizing and potential halting of mega-infra projects like the ECRL, HSR, MRT3 whilst stemming the pilferage and expenditures by government agencies. The outflows from emerging markets in the past couple of months due to tightening interest rate differential with the US has dissipated somewhat for Malaysia as evident in the smaller reduction in foreign holdings for Malaysian debt securities ofr the month of August 2018. On the flip-side concerns will arise if the ongoing global trade issues mainly between US and China stay unresolved.

Fed dot plot implies 2 additional Fed rate hikes for 2018 making it a total of 4 for the year...

The recent movement of US Treasury yields in August saw the curve move lower and resume its flattening bias despite the unusual steepening mode earlier with the 2s10s and 5s30s spreads expected to narrow and test the recent lows of 18bps and 19bps respectively. 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 may not be derailed as the economy may be shielded from the trade tensions by the \$1.5 trillion tax cut package and increased govt spending. Despite the swelling issuance of debt by the U.S. Treasury Department; the bond market has proven remarkably resilient as investors; mainly global lifers and pension funds continue to back-up demand as is the case this week in September whereby a combined \$73b of 3Y, 10Y and 30Y hit the market

The UST 10Y which trended well below 3.00% in August save for a brief period early in the month is currently at 2.85% levels at the time of writing (previous high of 3.11% on 13th June). It is expected to rise on interest rate hike expectations in the upcoming FOMC on 26th September amid strong economic data. Expect UST 10Y to maintain and oscillate between the 2.90-3.10% levels for September as traders dabble in shorts. The current yield curve is expected to continue its flattening-bias as economy may be

showing signs of under-estimation in inflation. The downside risks to the above are the negative impact on global trade barrier issues especially pertaining to US-China negotiations. Nevertheless, expect short-duration portfolios to be adopted by fund managers if and when investors switch asset classes from risk-on to risk-off mode.

In the Corporate space, investors are expected to be rewarded in Investment Grade issuances instead of High Yield with positive returns, led by the UST curve flattening as these corporates are better-equipped to weather the test of global trade uncertainties amid better funding opportunities.

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