May 17, 2018

Global Markets Research

Fixed Income

Monthly Perspective – May 2018

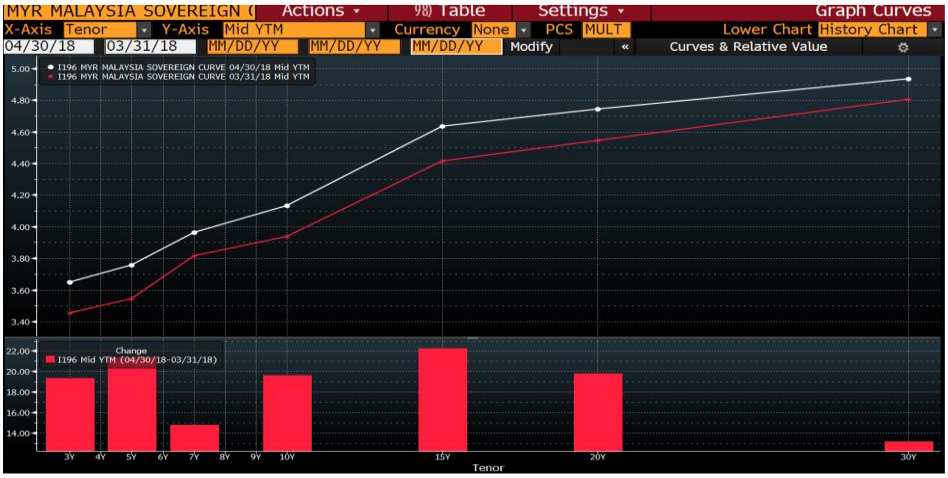
MYR Bond Market

Recapping the month of April

On the global front, April saw higher inflation readings despite slightly weaker US payrolls; causing US Treasuries (UST's) to resume an upward trajectory. Global corporate bonds declined as well but outperformed government bonds. The front-end rates i.e. 2Y UST rose 21bps closing at 2.48% reflecting risks of further hikes in the overnight Federal Funds Rate by the FOMC; continuing form the last one seen in March. The dollar has gained since mid-April as easing tensions in the Korean Peninsula and moves by China and the United States to avoid a full-blown trade war allowed investors to focus on the yield advantage the US enjoyed over other countries. Fears of inflationary pressures did pose some threats with the long-bond spiking by 15bps to 3.12%. The 10-year, which depicts as a benchmark for US mortgage rates, borrowing costs for municipalities and also inflation indication, saw more volatility as it oscillated between a low of 2.73% and a high of 3.06% before closing higher by 19bps at 2.93%; due more to risk-on environment; despite the tepid 0.3% rise in the S&P 500 to 2,648 in April. (Note that the UST 10Y closed at 2.41% as at end-2017).The US yield curve which flattened considerably by about 10-15bps earlier in March maintained a similar pattern for the month April with 2s10s spread at about 46bps whilst the 5s30s spread tightened further to a low of 32bps.

On the local front, there was less interest for MYR bonds in April with overall foreign holdings reversing the earlier month's inflows on dwindling trade volume of RM52.5b versus RM84.3b the prior month. The net outflows of RM4.7b M-O-M saw foreign holdings drop substantially to RM205.4b. The pull-back in foreign holdings of RM181.5b in both MGS and GII represents 26.5% of total outstanding MYR government bonds consisting of MGS+GII+SPK. (Mar: RM184.8b or 27.4% of total outstanding). Corporate Bonds however saw marginal decrease of RM835m in foreign holdings to about RM15.1b. We note that MYR bonds notched lower trading volume in April due to uncertainties then related to GE14 and the threat of rising interest rates in US. Overall benchmark MGS yields were lower by 13-23bps MOM due primarily to outflows by foreign investors and inter-bank players with some support seen by institutional investors. Both the 7Y MGS 3/25 and much-watched 10Y MGS 11/27 closed higher on yields at 3.96% and 4.13% respectively.

MYR sovereign curve (MGS)



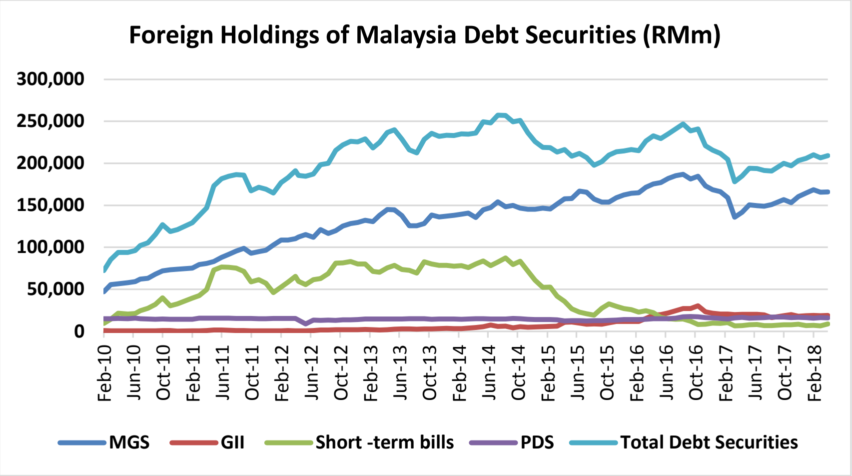
Source : Bloomberg

Weaker headline NFP for April; softer wage gains not seen dampening Fed rate hike expectations

April Non-Farm Payrolls ("NFP") print disappointed and came in lower at 164k compared to consensus or market expectations of 192k. It was however higher than the recent March low of 103k. Despite the somewhat weaker jobs data, the unemployment rate dropped to a near 17.5-year low of 3.9%; although this was driven in part by Americans leaving the labor force. Nevertheless, the quicker wage gains meanwhile reinforce prospects of interest rate increases in the US. With optimism over rising economic activity in the US, especially following the ongoing Tax Plan and Fed's balance sheet reduction/portfolio run-offs, With the Dollar Index reaching a 2018 high of 93.39, investors are expected to believe that inflationary pressures will cause the Federal Reserve to hike interest rates at least thrice for 2018 overall; with the first completed in March and the next one expected in June. The downside to the above would be the worsening US-China trade barrier tensions emanating and/or to a smaller degree potential geo-political tensions with Russia or North Korea which may trigger flight-to-safety bids for USTs.

Foreign Holdings of MYR bonds nose-dived in April, zig-zagging for the past five consecutive months…

Foreign holdings of MYR bonds were lower for the month of April 2018 with total holdings sharply down by RM4.7b or 2.2% to RM205.4b versus RM210.1b the previous month. The non-resident holdings of MGS dropped substantially by RM3.1b at RM162.8b; representing 44.3% of total outstanding) whereas total MYR Govt bonds (i.e. MGS+GII+SPK) holdings saw a reduction of RM3.2 or 0.9% to RM181.5b (26.5% of total outstanding); the lowest month of foreign holdings for this year. Nevertheless the lowest recorded was RM161.7b recorded in April 2017.



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OPR maintained at 3.25% as emphasis was on policy normalization

BNM expectedly maintained the OPR at 3.25% at its recent May MPC meeting (following a 25bps hike in January). The central bank also continued to strike a neutral tone stating that the domestic economic outlook remains positive whilst the financial sector remains strong and monetary and financial conditions are supportive of economic growth in the post-election environment. BNM is confidently ahead of the curve; being one of the first central banks to raise rate early in the year and faces less pressure to tighten further for now. The MYR is now seen as one of Asia's best Asian currencies YTD with a 1.9% gain against USD. The early move was a preemptive one as the central bank was seen embarking on normalization of policy rather than a tightening trend; and raises its 2018 growth outlook in an annual report released in March; projecting GDP to expand 5.5-6.0% compared to the previous growth forecast of 5.0-5.5%

MYR government bond auctions saw strong support for new benchmark 10Y GII, 20Y GII reopening in April followed by new benchmark 15Y GII and 7Y reopening in May

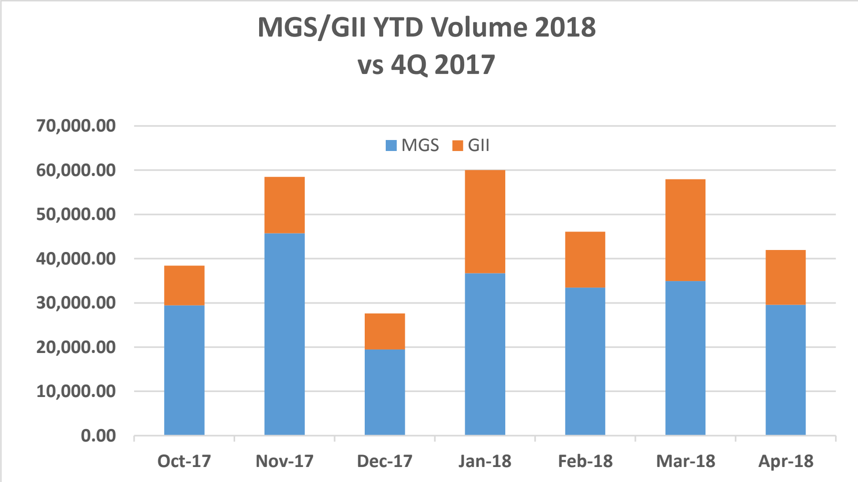
MGS/GII issuance pipeline in 2018

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		3,500								
16	5.5-yr New Issue of MGII (Mat on 11/23)	5	May	Q2		4,000								
17	20-yr New Issue of MGS (Mat on 06/38)	20	Jun	Q2		3,000								
18	15-yr Reopening of MGII (Mat on 06/33)	15	Jun	Q2		2,500								
19	30-yr New Issue of MGS (Mat on 07/48)	30	Jul	Q3		3,000								
20	10-yr Reopening of MGII (Mat on 10/28)	10	Jul	Q3		3,000								
21	7-yr Reopening of MGS (Mat on 03/25)	7	Jul	Q3		3,500								
22	20-yr Reopening of MGII (Mat on 08/37)	20	Aug	Q3		2,000								
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 supply in 2018					102,500	41,500	6,500						

The three government bond tenders concluded for the month of April 2018 under the auction calendar included the new issuances of 5Y MGS 4/23, 10Y GII 10/28 and the also the reopening of 20Y GII 8/37 which altogether saw decent BTC support averaging 2.13x; higher than the 2.03x for all auctions the previous month. This was also similar to the average BTC of 2.20x for the entire of 2017 consisting of 32 issuances in total and denotes a vast improvement when compared to the YTD BTC of 2.05x for 2018. Tenders for the month were well received by both local and foreign investors. In addition to that the just-concluded 7Y new issuance of GII 8/25 on 14th May saw a whopping BTC of 3.397x averaging 4.202%.

Trading volume for MGS/GII rebounded in April

Trading volume for MYR govvies similarly dropped from about RM57.9b in March to a mere RM41.9b during April. The drop was seen across all tenures with substantial trades seen in the short to mid-tenured off-the-run 18-21's and also the much-watched and popular 10Y benchmark MGS 11/27 which altogether topped frequency of trades for the month as mainly offshore investors were net sellers of ringgit government bonds on emerging market concerns arising from rising rate hikes and UST Treasury yields. The market was also seen lukewarm following the dissolution of parliament ahead of the all-important General Elections i.e. GE14 on 9th of May.



Source : BPAM, Bloomberg

Corporate bonds/sukuk interest was still sustainable on yield and liquid names

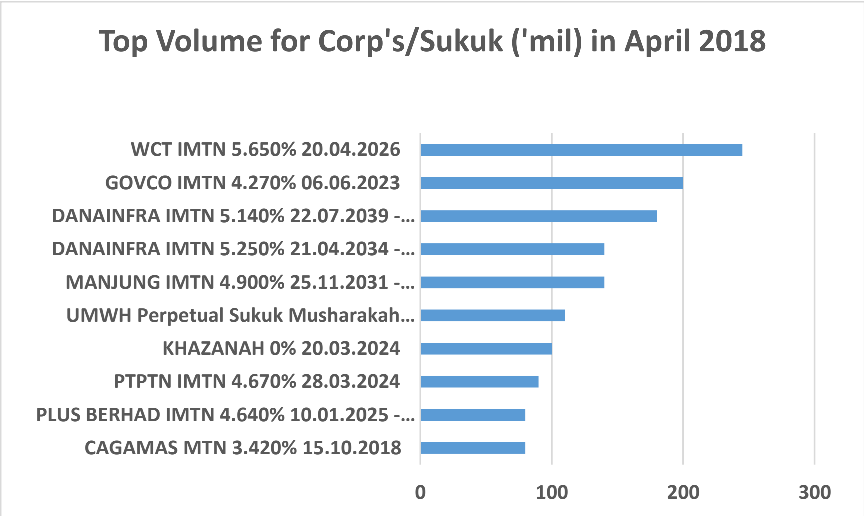
In the secondary market, the monthly trading volume for corporate bonds/sukuk (including Govt-Guaranteed bonds) also eased from RM16.9b in March to RM10.2b in April. We note investors were skewed more down the curve i.e. the AA-rated space with 42% market share of total trades (Mar: 24%) as investors looked for yield-enhancement opportunities whilst Govt-guaranteed and AAA-part of the curve saw trades almost halved. For ease of reference we have excluded single-A rated and non-rated papers in the following graph.

Source : BPAM, Bloomberg

Primary issuance print in April boosted by the following names:

Notable issuances for Apr-18	Rating	Amount Issued(RM mil)
MBSB Bank Berhad (fka Asian Finance Bank Berhad)	AA1	2,295
Boustead Holdings Berhad	NR	150
Cagamas Berhad	AAA	400
CUCMS Education Sdn Berhad	NR	28
Eco World International Berhad	NR	180
Fenghuang Development Sdn Berhad	NR	19
Glenealy Plantations (Malaya) Sdn Berhad	NR	48
Jaya Persada Sdn Berhad	NR	80
Johor Port Berhad	GG	50
Liziz Standaco Sdn Berhad	NR	13
Lembaga Pembiayaan Perumahan Sektor Awam	GG	3,000
MKD Kencana Sdn Berhad	GG	1,300
OSK I CM Sdn Berhad	NR	50
Pavilion REIT Bond Capital Berhad	NR	700
Public Bank Berhad	AAA	AAA
Sabah Development Bank Berhad	AA1	250
SunREIT Unrated Bond Berhad	NR	400
TSH Sukuk Ijarah Sdn Berhad	AA3	30
UiTM Solar Power Sdn Berhad	AA3	222
UMW Holdings Berhad	A1	1,100
WCT Holdings Berhad	AA3	310
		10,625

Source : Bloomberg/ BPAM



Source : Bloomberg/ BPAM

Outlook for May

Paradigm shift as new Govt is sworn-in with swift initial changes to fiscal policy has not dented demand for bond auctions with BTC ratios exceeding 2.0x…

The reopening of the 7Y GII 8/25 was well-received with a BTC ratio of 3.397x; averaging 4.202%. This was preceded by the equally impressive auction for the new issuance of 15Y MGS 11/33 in early May notching strong BTC of 2.722x; averaging 4.642%. The impressive average BTC's of 2.03x for the earlier four (4) auctions in month of March was superseded by the three (3) auctions in April consisting of 20Y GII 8/37 and new issuances of 5Y MGS 4/23 and 10Y GII 10/28 which altogether garnered an average BTC of 2.13x. We maintain our view of softer inflationary outlook this year. This coupled with moderating growth and the return in real interest rate to positive territory, (where real interest rates are expected to stay comfortably positive in 2018), are expected to allow BNM to keep OPR unchanged for the rest of the year.

The Ringgit is seen to be resilient although some weakness is anticipated in May stemming from initial impact due to changes in fiscal policies namely the resetting of GST to zero coupled with potential outflows from emerging markets due to narrowing interest rate differential compared with US. However these may be mitigated by the continued strength of the Malaysian economy; boosted by steady oil prices and potential cut in government expenditures.

Expect liquidity in govvies to soften initially; followed by confidence-boosting measures to ascertain that the citizens and economy as a whole is on track in the coming months post-election. Meantime demand for Ringgit Corporate bonds is expected to hinge on any revision/changes in Terms and Conditions awarded in major privatized and other infra-related projects i.e. highways, power-plants etc which require thorough credit assessments.

The odds of two additional Fed rate hikes for 2018 with one as early as June is on the cards; Fed dot plot not expected to change for the month

The recent rise of US Treasury yields which resulted from the rising wage costs and inflationary pressures has caused volatilities in the Fixed income space. The Fed's expectations along with its "dot plot" coupled with further issuances by the Treasury to fund the deficit arising from the imposition of the Tax proposal budget spending will be seen as major indicator of interest rate movement in the US. The ongoing pace of balance sheet reduction by the US Fed is expected to see elevated US Treasuries yields in the month of May as earlier predictions of another two (2) potential Fed rate hikes go full throttle. The much-watched 10Y has finally breached 3.00%; and is at 3.08% at the time of writing. Nevertheless with yields turning attractive; foreign capital from two of the largest holders of UST's i.e. China and Japan is anticipated flow into this asset class.

Expect yields to oscillate with volatility due to potential geopolitical tensions arising intermittently between US-Russia-North Korea and trade tensions between US-China. Gyrations are also expected as investors switch asset classes on risk on-off mode. Mild flattening of the yield curve is expected to continue as over-estimation of inflation remains evident. In the Corporate space, investors may be seen to prefer Investment Grade issuances over High Yield ones as companies with strong balance sheets and lower level of debts are deemed able to be able to finance their operations and counter the impact of potential rising rates.

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