Monthly Perspective – July 2018

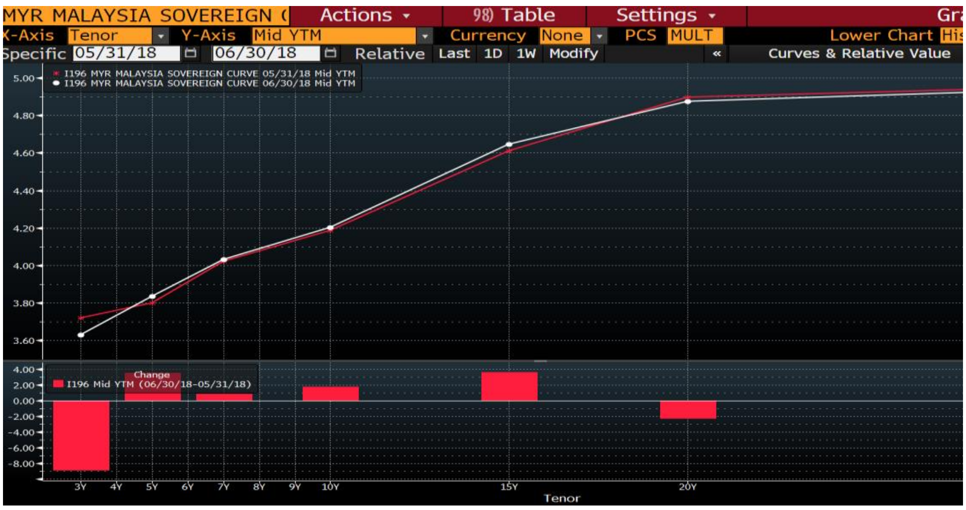
MYR Bond Market

Recapping the month of June

*In the US, June saw mixed signals with tepid data on inflation readings despite solid US payrolls; causing **US Treasuries** (UST's) to end mixed; short maturities climbed as the Fed raised the Federal Fund Rates for the 2nd time in June by 25bps to 1.75-2.00% range whilst 30Y yields declined as US threats of trade protectionism hurt equities and dented economic optimism. The front-end rates i.e. 2Y UST spiked 6bps higher at 2.53%. The dollar had generally gained 1.0-3.3% against G10 currencies in June with the Dollar Index strengthening at ~94 levels; allowing investors to focus on the yield advantage the US enjoyed over many other countries. The 10Y, which depicts as a benchmark for US mortgage rates, borrowing costs for municipalities and also inflation indication, oscillated between a low of 2.83% and a high of 2.97% levels before closing 4bps lower at 2.86%; due more to risk-off environment. (Note that the UST 10Y closed at 2.41% as at end-2017).The US yield curve continued to narrow considerably to the lowest levels since 2007 in June with 2s10s spread tightening from 42bps to 25bps whilst the 5s30s moved from 33bps to 20bps.*

*On the local front, contrasting signals on volume versus yield movements emerged as overall **MYR bonds** saw foreign holdings continue the prior month's outflows on dwindling trade volume of R42.6b versus RM61.7b the prior month. June saw foreign holdings dropping RM6.6b M-O-M to RM185.8b, a milder pace compared to May's RM12.9bn. The pull-back in foreign holdings to RM165.1b levels in MYR Govvies represents 23.7% of total outstanding MYR government bonds consisting of MGS+GII+SPK. (May: RM171.7b or 24.9%). Corporate Bonds/Sukuk however saw consistent levels of foreign holdings at about RM14.2b. We note that MYR bonds reversed the trend with Govvies closing mixed on lower volume in June whereas Corporate Bonds/Sukuk saw volume spike as investors chased for yields for their portfolios following the clearance of uncertainties related to major infrastructure projects and fiscal policies post-GE14. Overall benchmark MGS yields were mixed between -8 to +4bps across the curve which witnessed prominent convexity due to both the short and ultra-long bonds ending lower on yields compared to other tenures. The 7Y MGS 3/25 and 10Y MGS 11/27 closed 2-4bps higher at 4.06% and 4.20%.*

MYR sovereign curve (MGS)



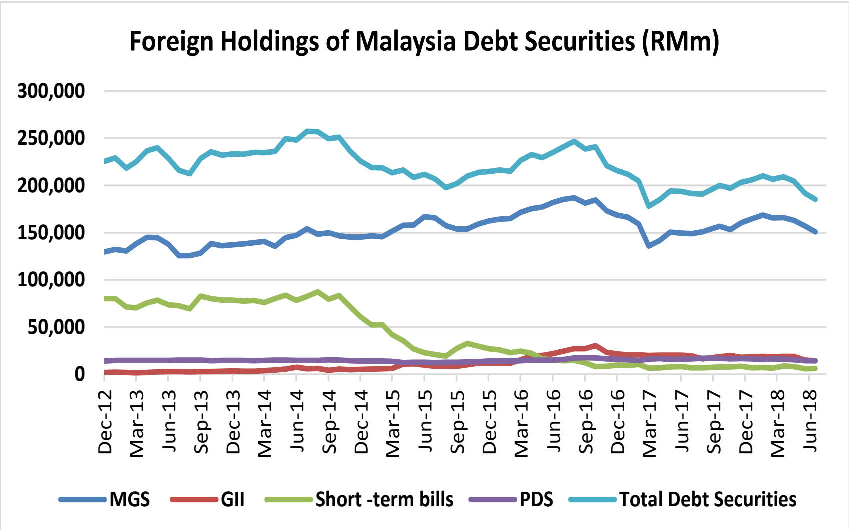
Source : Bloomberg

Mixed signals seen as headline NFP for May was solid whilst wage gains and unemployment rate unexpectedly softened….

June Non-Farm Payrolls ("NFP") print continued strong at 213k compared to market consensus of 195k. It was marginally lower than May's 223k but well-above April's figure of 164k. Despite the solid jobs data, the unemployment rate however rose to 4.0%; the first rise in almost a year from 3.8% prior month and wage gains including average hourly earnings unexpectedly slowed. Nevertheless the prospects of further interest rate increases in the US with near full-term employment are still seen over the horizon due to optimism over rising economic activity in the US; following the Tax reform-specifically tax cuts which seem to push growth to an even faster pace and the Fed's balance sheet reduction/portfolio run-offs which may lead to inflationary pressures (The first two were completed in March and recently in June). This ought to provide a buffer against the negative impact arising from escalating trade tensions. Hence the Federal Reserve is expected to hike interest rates up to four (4) times in 2018. The mitigating factors to the above would be the continued danger from the impact of trade tariff issues involving US and others including China, EU, Canada, and Mexico; potentially triggering a flight-to-safety bids for USTs.

Foreign Holdings of MYR bonds continued to nose-dive in June; intensity of selling has reduced…

Foreign holdings of MYR bonds were lower for the third consecutive month in June with total holdings sharply down by RM6.6b or 3.4% to RM185.8b versus RM192.5b the previous month. The non-resident holdings of MGS dropped substantially by RM6.0b at RM150.9b; representing 40.1% of total outstanding) whereas total MYR Govt bonds (i.e. MGS+GII+SPK) holdings saw a sharp reduction of RM6.6b or 5.4% to RM165.1b (23.7% of total outstanding); the lowest month of foreign holdings since last April's RM161.7b.



Source: BNM, HLB Research

OPR maintained at 3.25% as emphasis was on policy normalization

BNM continued to maintain the OPR at 3.25% at its recent MPC meeting on 11th of July (following the 25bps hike in January). The central bank which recently appointed Nor Shamsiah Mohd Yunus as the new Governor 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. The early move was a preemptive one as the central bank was seen embarking on normalization of policy rather than a tightening trend. Hence, BNM is seen to have ample room to keep policy unchanged despite the emerging market sell-off that has forced neighboring countries like Philippines and Indonesia to aggressively step-up measures to defend their respective currencies. The overall tone of the statement is neutral and not as dovish as believed by some investors. Despite USDMYR upward move from 3.9800 to 4.0400 levels in June, 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 varies with our house view at 5.0% versus an annual report released in March by BNM; projecting GDP to expand 5.5-6.0%.

MYR government bond auctions saw decent support for new benchmark issuance of 20Y MGS and 30Y MGS whist the 15Y GII reopening saw strong bidding

MGS/GII issuance pipeline in 2018

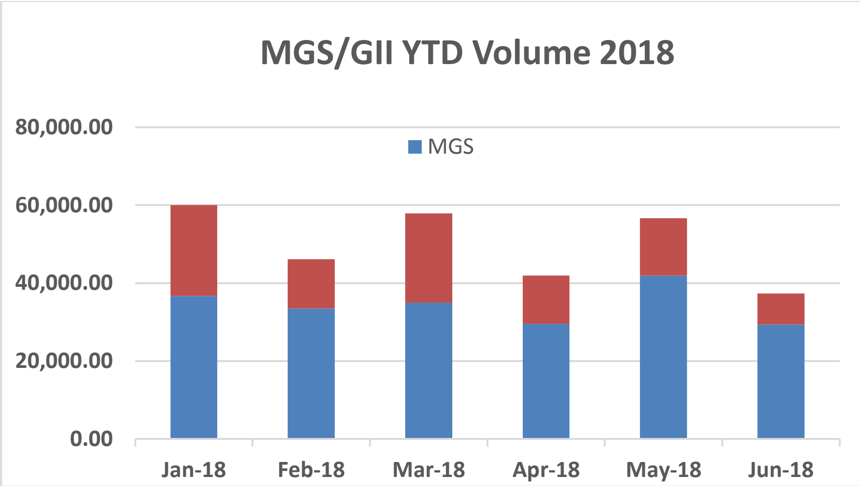
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Total Expected Size (RM mil)	Auction Issuance (RM mil)	Private Placement	Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	20-yr Reopening of MGS (Mat on 04/37)	20-Jan-00	Jan	Q1	4/1/2017	3,000	2,000	1,000	2,000	1.905	4.573	4.607	4.640	14.3%
2	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		3,000								
21	7-yr Reopening of MGS (Mat on 03/25)	07-Jan-00	Jul	Q3		3,500								
22	20-yr Reopening of MGII (Mat on 08/37)	20-Jan-00	Aug	Q3		2,000								
23	15-yr Reopening of MGS (Mat on 11/33)	15-Jan-00	Aug	Q3		3,500								
24	5-yr Reopening of MGII (Mat on 11/23)	05-Jan-00	Aug	Q3		3,000								
25	30-yr Reopening of MGII (Mat on 05/7)	30-Jan-00	Sep	Q3		2,000								
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 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								
	Actual gross MGS/GII supply in 2018					102,500	57,000	6,500						

Source: BNM, HLB Research

The two(2) government bond tenders concluded for the month of June 2018 under the auction calendar included the new issuances of 20Y MGS 6/38 and the reopening of 15Y GII 6/33, which together saw strong BTC support averaging 2.34x; not far-off from the 2.43x for all four(4) 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 2.243x for 2018). Tenders for the month were well received mainly by local institutional investors with some spillovers from foreign. Worth noting was that the 15Y reopening of GII 6/33 on 14th May saw a whopping BTC of 2.783x averaging 4.778% versus its prior auction of a mere 1.996x; averaging 4.55%.

Trading volume for MGS/GII plunged in June

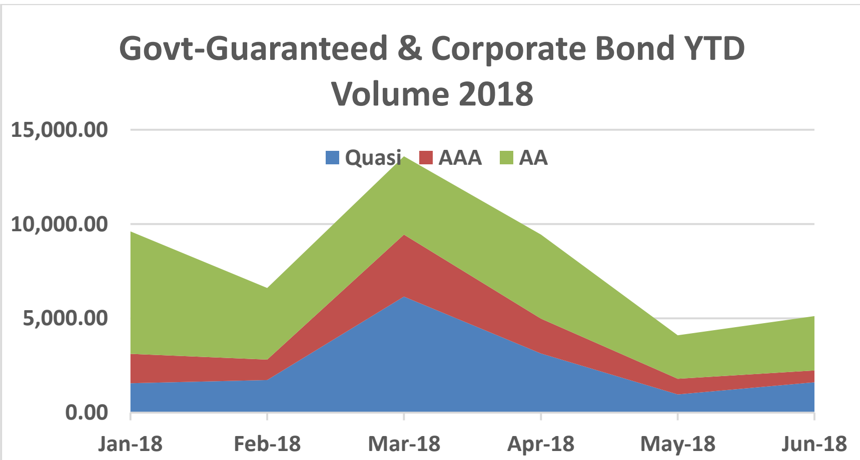
Trading volume for MYR govvies lost traction as volume plunged from about RM56.6b in May to RM37.4b during June. The decrease was seen across most tenures with substantial portion of trades seen in the short to mid-tenured off-the-run 18-21's and also the MGS 4/33 which altogether topped frequency of trades for the month. Nevertheless off-shore investors continued to be mainly net sellers of ringgit government bonds on emerging market concerns arising from widening US-Asia interest rate differentials, US-China trade rumblings and also fiscal deficit concerns following May's GE14 results on 9th of May.



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) turned north following a dip in May as volume jumped from RM3.7b in May to RM5.0b in June. Investors were skewed towards GG bonds high up the curve @ 30% of total market share of trades; followed by the AA-rated space @ 52% market share of total trades (April: 46.2%) as investors were locked between credit-enhancement and yield-bearing opportunities. GG bonds were in demand due to the high possibility of Govt's containment of further contingent liabilities as opposed to earlier expectations of continued GG-bonds. Volume on AAA-rated bonds were however muted for the month under review. YTL Power 5/27 (AA) and BUMITAMA 9/19 (AA) topped the monthly volume; followed by DANAINFRA 10/28 as appetite was also shown on infrastructure-related bonds including power-related and toll-related bonds 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.

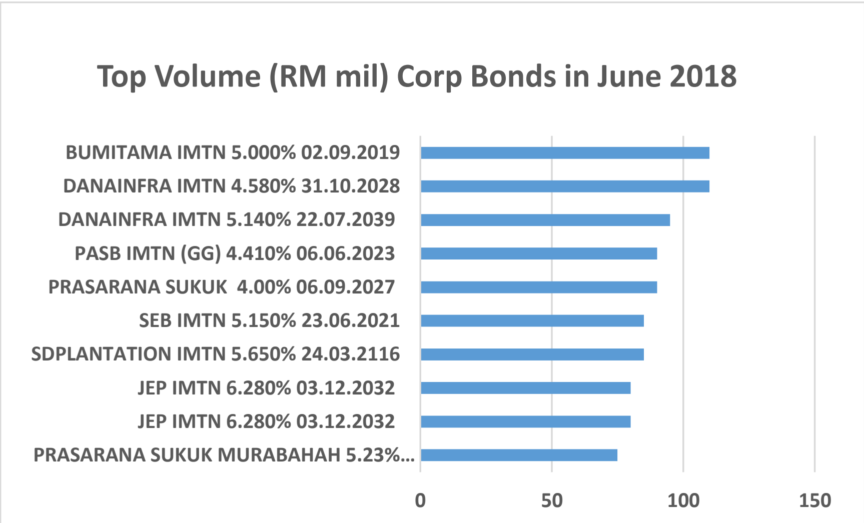


Source : BPAM, Bloomberg, HLB Research

Primary issuance print in May boosted by the following names:

Notable issuances for June-18	Rating	Amount Issued(RM mil)
AmBank (M) Berhad	AA2	700
BTS Car Park Sdn Berhad	NR	200
CIMB Group Holdings Berhad	AA1	350
DRB-Hicom Berhad	A1	390
Fenghuang Development Sdn Berhad	NR	28
Hong Leong Bank Berhad	AA1	500
Hong Leong Financial Group Berhad	AA2	500
KYS Assets Sdn Berhad	NR	30
Liziz Standaco Sdn Berhad	NR	28
Mercedes-Benz Services Malaysia Sdn Berhad	AAA	250
Pengurusan Air SPV Berhad	GG	2,100
Public Bank Berhad	AA3	100
Point Zone (M) Sdn Berhad	NR	100
QSR Stores Sdn Berhad	NR	400
Southkey Megamall Sdn Berhad	NR	100
Sports Toto Malaysia Sdn Berhad	AA3	120
Sunway Treasury Sukuk Sdn Berhad	NR	200
Tiger Synergy Berhad	NR	4
		6,100

Source : Bloomberg, BPAM, HLB Research



Source : Bloomberg, BPAM, HLB Research

Outlook for July

Government has addressed fiscal policy concerns but headwinds may persist due to global trade barriers and tightening of US-Asia interest rate differentials…

The decent BTC support for the only (2) auctions in June averaged 2.34x and is only marginally lower 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 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 be resilient although some weakness is anticipated stemming from initial impact due to revamp in fiscal policies; arising from election manifestos before GE14. 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. The outflows from emerging markets in the past couple of months due to tightening interest rate differential compared with US is expected to abate due to some of the abovementioned measures coupled with continued strength of oil prices and the Malaysian economy as a whole. Nevertheless the downside to all of these would be the potential impact on trade balances arising from the long-drawn “global trade war” initiated by the US.

We expect a pick-up in liquidity for local govvies following clarity and confidence-boosting measures by the new PH government. Values are seen emerging in the 15Y space for now. Demand for Ringgit Corporate Bonds/Sukuk is expected to see an uptick as credit concerns over infra-related projects i.e. highways, power-plants dissipate on clarity of measures. We foresee demand for Government-Guaranteed (GG) bonds in view of potential lack of supply going forward.

Fed dot plot implies two (2) additional Fed rate hikes for 2018 making it a total of four (4) for 2018

The recent movement of US Treasury yields in June saw the curve flattening which is a cause for concern with the 2-10Y gap narrowing to its smallest level since 2007 at 25bps. With the economy accelerating with direct implications on wage-cost pressures and interest rate policy mentioned above; the “subtle recalibration” instead of a hawkish shift leaning to four (4) and not three (3) rate hikes in total for 2018. This may also be due to further issuances by the Treasury to fund the deficit arising from the imposition of the Tax budget and additional spending. Nevertheless the possibility of portfolio capital inflows from two of the largest holders of UST’s i.e. China and Japan is forthcoming as yields become attractive. Add to that the relief due to the absence of geopolitical tensions.

It is envisaged that the UST 10Y which stayed below 3.00% in June (currently at 2.87% levels at the time of writing) may attempt to test the 3.00% area again in July due to interest rate hike fears and over-estimation of negative impact on global trade barrier issues. Flattening of the yield curve is expected to continue as economy may be showing signs of under-estimation in inflation Short-duration on portfolios are expected to be adopted as investors switch asset classes on risk, on-off mode. On the flip-side, in a worst-case scenario of a fully-fledged trade war; rates can drop across the curve by ~20bps. In the Corporate space, investors are 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 finance their operations and weather the impact of rising rates.

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