Monthly Perspective – Dec 2018

MYR Bond Market

Recapping the month of November

The US saw a dip in payrolls for November with US Treasuries (UST's) curve shifting lower as price gains were seen across most tenures whilst equities were sold off. Most tenors saw a rally with yields lower between 8-15bps with the curve flattening especially up to the 10Y tenure following global growth tantrums and tightening of financial conditions since the September FOMC. The front-end rates i.e. 2Y UST yields fell by 8bps to 2.79% levels whilst the 10Y, which depicts as a benchmark for US mortgage rates, borrowing costs for municipalities and also inflation indicator, displayed volatility as it oscillated between a low of 2.94% and a high of 3.24% levels before rallying 15bps lower MOM at 2.99% levels. The dollar had generally ended mixed against the G10 currencies i.e. strengthening between 0.13-0.55% against the Pound and Yen but ending 3.29-5.45% weaker against the Kiwi and Aussie in November as the Dollar Index stayed pat at 97 levels. The US yield curve saw little changes, as the 2s10s spread widened from 27 to 31bps whilst the 5s30s spread remained unchanged at about 40bps.

*On the local front, **MYR bonds** saw reversal in foreign holdings in November compared to prior month's impressive increase on attractive yield levels amid lower trade volume of RM50.4b (Oct:RM56.3b). The foreign holdings decreased by RM5.2b MOM to RM187.1b, compared to October's inflows of RM7.8b. The percentage of foreign holdings of MYR government bonds fell to 23.1% or RM162.5b of total outstanding MYR Govvies consisting of MGS+GII+SPK. (Oct: RM167.7b or 23.2%). Overall benchmark MGS/GII bonds ended mixed with the front-end and belly higher between 3-6bps whilst bond yields extending further out from the 10Y rallied between 2-3bps. The 5Y MGS 3/25 rose 6bps higher at 3.86% whilst the much-watched 10Y MGS 6/28 whose volume plunged by half saw yields rise 5bps to 4.13% levels. Corporate Bonds/Sukuk however saw a marginal drop of RM276m in the levels of foreign holdings at RM14.3b. Portfolio investors (mainly local) were still net buyers as bonds saw strength; causing yields to end lower for Corporate Bonds/Sukuk due to the hunt for yields*

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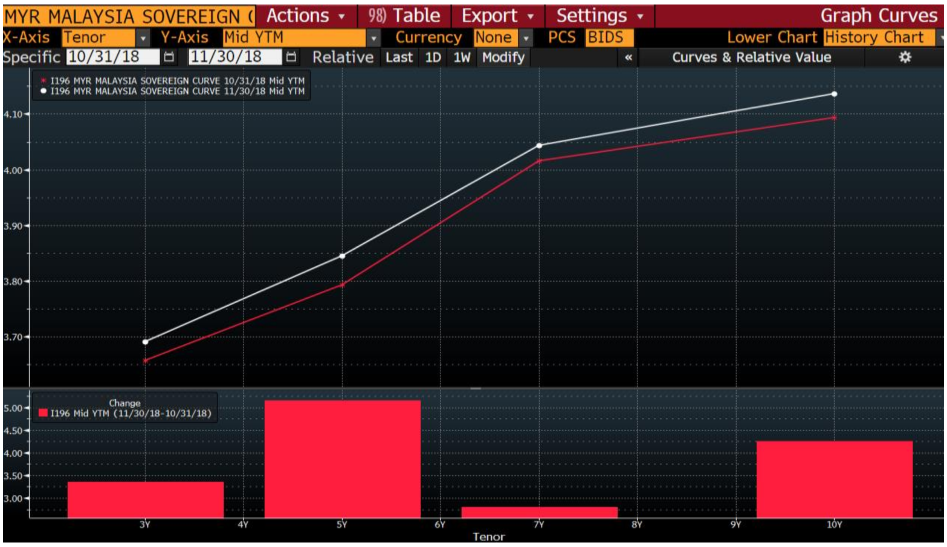
MYR sovereign curve (MGS)



Source : Bloomberg

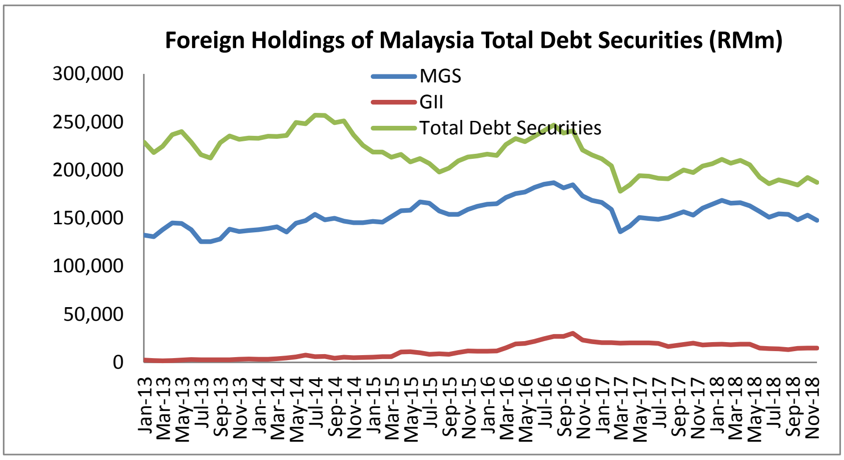
NFP for November pulled-back; strong wage gains sustained as unemployment rate remains at multi-decade lows….

November Non-Farm Payrolls ("NFP") printed 155k compared to market consensus of 198k (Oct: 237k revised) pointing to lack of further labor market tightening whilst the unemployment rate was kept steady at 3.7% which continues to trend out at the lowest levels since 1969 (Oct: 3.7%). This denotes extended confidence in job prospects which is expected to maintain wages and was evident in the sustained average hourly earnings growth of 0.2% MOM in November. Nevertheless data is being closely monitored by the Fed for continuance of evidence of diminishing slack in the labor market and upward pressure on inflation. Hence the current solid data that is expected to reassure that the economy is on a sound footing may strongly support the case for a 4th and final interest rate increase for 2018 when policy-makers meet on 20th December following three(3) Fed hikes to 2.00-2.25% year-to-date.

To recap, the US central bank said in its FOMC statement dated 9th November that the labor market has continued to strengthen and that economic activity has been rising at a strong rate. Job gains have been strong on average in recent months and the unemployment rate has maintained its low levels. Household spending has continued to grow strongly whilst growth of business fixed investment has moderated from its rapid pace earlier in the year. However, its preferred inflation measure for November i.e. the core PCE, was unchanged by 0.2% MOM but marginally higher at 2.2% YOY (2.1% in October). These latest CPI readings now reveal the extent of the impact on inflation that will permeate the economy despite the lower fuel prices for the past month. Also, the tax reform-specific cuts which has helped accelerate economic growth and the Fed's balance sheet run-offs may lead to inflationary pressures and cause rates to rise faster than expected. However, mitigating factors that may derail the rate hike path is the potential fallout arising from escalating US-China trade and geopolitical tensions (if any) which will provide safe-haven bids for UST's.

Foreign Holdings of overall MYR bonds fell sharply in November amid slower momentum amid the ease in Sep-Oct rout in EM's…

Foreign holdings of MYR bonds saw another month of decline in November with total holdings lower by RM5.2b or 2.7% to RM187.1b. The non-resident holdings of MGS was substantially lower by RM5.4b to RM147.6b; representing 38.8% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw decline of RM5.1b or 3.1% to RM162.5b (23.1% of total outstanding); the lowest level of foreign holdings for the year.



Source: BNM, HLB Research

OPR ends the year at 3.25% on global trade tension concerns…

BNM maintained the OPR at 3.25% at the last MPC meeting of the year on 8th of November amid low inflation and re-adjustment of economic growth expectations for the year (Note: that the last hike was 25bps in January). The central bank reiterated its outlook of steady growth and stable underlying inflation is one of the several factors that favors a neutral stance. Further tightening is expected to however add to the government's challenging debt service burden whist lower rates would diminish the yield appeal of MYR bonds; making it more difficult to restructure its debt if and when the need arises. Despite the earlier improvement in portfolio inflows in October following the EM sell-off during the August-September period; the month of November saw a reversal i.e. net portfolio outflows instead. (Note: Net outflows post GE14 in May this year have deteriorated from RM13.8b to about RM19.7b). Nevertheless the USDMYR continued to trade at 4.1840 levels as at end-November but ultimately more resilient YTD than most Asian currencies like Won, Yuan, Peso, Rupiah and Rupee. 2018 growth outlook has been revised lower with BNM projecting a GDP of 4.8% with our house view pegged at 4.6%.

MYR government bond auctions saw solid demand for reopening of ***5Y and 7Y govvies***

MGS/GII issuance pipeline in 2018

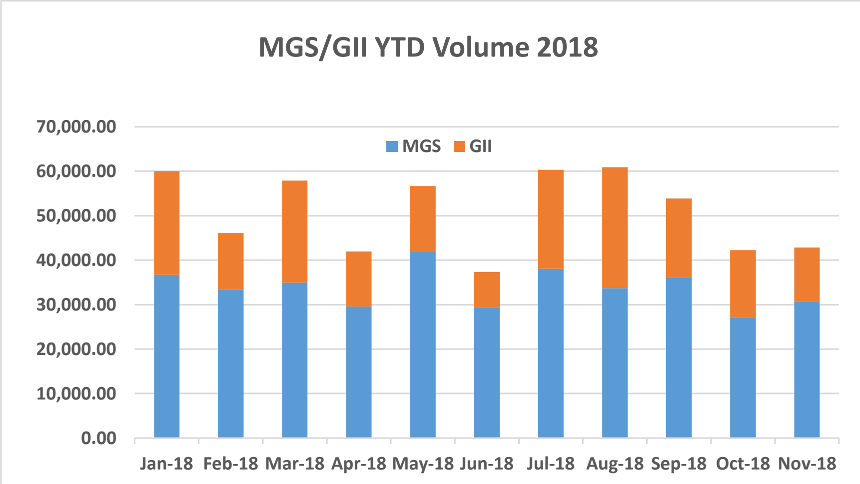
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Total Expected Size (RM mil)	Auction Issuance (RM mil)	Private Placement	Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	20-yr Reopening of MGS (Mat on 04/37)	20	Jan	Q1	4/1/2017	3,000	2,000	1,000	2,000	1.905	4.573	4.607	4.640	14.3%
2	5-yr Reopening 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	12/10/2018	3,000	3,000		84,000	1.657	4.730	4.759	4.785	27.5%
29	10-yr Reopening of MGII (Mat on 10/28)	10	Oct	Q4	30/10/2018	3,500	4,000		88,000	2.235	4.290	4.313	4.320	90.9%
30	7-yr Reopening of MGII (Mat 08/25)	7	Nov	Q4	14/11/2018	3,000	3,000	2,500	91,000	2.814	4.203	4.212	4.218	63.6%
31	5-yr Reopening of MGS (Mat on 04/23)	5	Nov	Q4	29/11/2018	4,500	3,500	1,000	94,500	2.316	3.855	3.874	3.880	45.5%
32	20-yr Reopening of MGII (Mat on 08/37)	20	Dec	Q4	6/12/2018	4,000	2,000	2,500	96,500	2.307	4.765	4.787	4.798	78.9%
33	3-yr Reopening of MGII (Mat on 03/22)	3	Dec	Q4	13/12/2018	3,500	3,300	500	99,800	2.426	3.765	3.775	3.782	88.6%
	Gross MGS/GII supply in 2018					107,500	99,800	13,000						

Source: BNM, HLB Research

The two (2) government bond tenders concluded for the month of Nov 2018 under the auction calendar included the reopening of the medium-tenured 7Y GII 8/25 and 5Y MGS 4/23. Both issuances saw a strong BTC ratios of 2.82x (averaging 4.212%) and 2.32x (averaging 3.874%). (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 2.23x for 2018 - i.e up to November 2018. Tenders for the month initially received strong support by both local and foreign institutional investors following the unveiling of the Malaysian Budget 2019 on 2nd November despite higher deficit scenario.

Trading volume for MGS/GII was well-maintained in November…

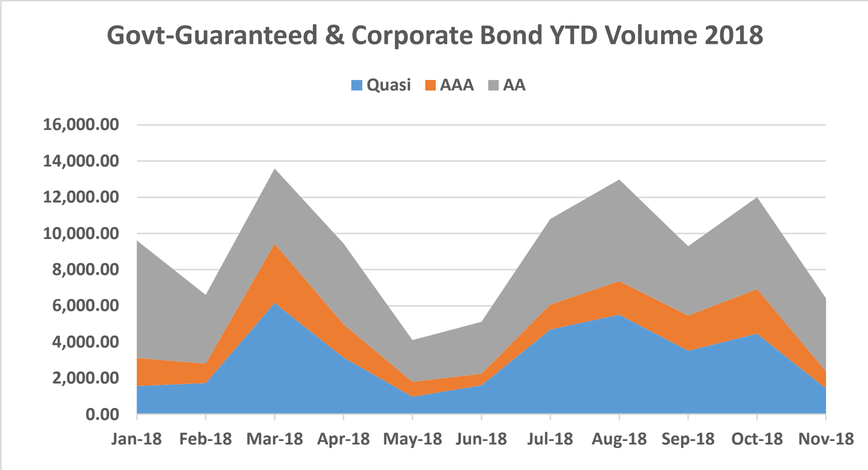
Trading volume for MYR govvies was maintained with volume at about RM43.2b for both months i.e. November and October at RM43.2b each. Traction was seen on selective parts of the curve with substantial frequency of trades and nominal amounts done in the short to mid-tenured off-the-run 19-20's (ended mixed between -15 to +4bps), 27's (ended +2bps), and also both MGS and GII benchmarks 10Y bonds (ended mixed between -2 to +5bps) which formed 11% of total volume for the month under review. Off-shore investors continued to turn net buyers in November on attractive valuations and also transparency and clarity on the back of decent economic data by the Malaysian government via the unveiling of the Malaysian Budget 2019. The month under review saw Malaysia emerge as one of the more attractive EM markets despite the earlier higher US interest rate outlook.



Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk interest turned quiet however…

In the secondary market, Corporate bonds/Sukuk (including Govt-Guaranteed bonds) saw a drastic drop in secondary market trading volume i.e. from RM13.1b in October to RM7.3b in November. Nevertheless there was still ongoing yield enhancement requirements by fund managers/portfolio investors despite lower liquidity conditions for this asset class involving credits following further potential US rate hikes and lack of sellers. Investor appetite for all three (3) i.e. GG, AAA and AA-rated bonds declined with Govt-Guaranteed bonds (GG) falling some two-thirds MOM. Overall, the AA-rated bonds formed some 63% of the November transactions as investors maintained the hunt for decent yield spreads over Govvies. Despite new GG bond issuances, investor demand was not fully met following the earlier lull in issuances post GE14 in May as the newly-elected government reigned in the nation's overall contingent liabilities by reviewing many infrastructure projects. The shorter GG bond PASB 6/20 and AAA-rated UOB 25NC20 topped the monthly volume; closing +2bps and -18bps respectively for the month compared to previous-done levels. This was followed by both the newly-issued Fortune Premier 9/25 (AA) and the longer-tenured SEB 12/32 (AA) which also closed mixed between -5 to +5bps. Appetite in the credit space was similarly seen in infrastructure-related bonds including energy and telecommunication sub-sectors of the economy i.e. AA-rated BGSM 18-23, MALAKOFF 18-31, Sarawak Energy Berhad 21-35, EDRA Energy 22-29, Southern Power Group 22-35, CELCOM 19-26 and TELEKOM 24-28. (We have excluded single-A rated and non-rated papers in the illustration below).



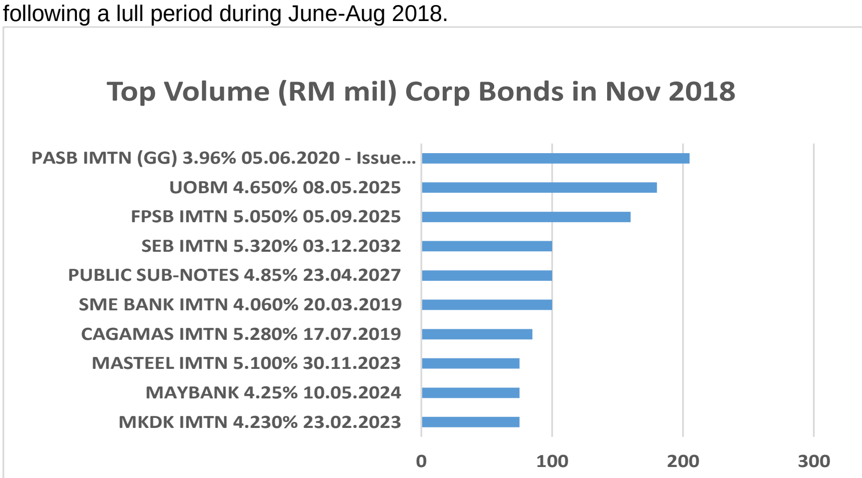
Source : BPAM, Bloomberg, HLB Research

Primary issuance print in November boosted by following names:

Notable issuances in Nov-18	Rating	Amount Issued (RM mil)
Alpha Circle Sdn Berhad	AA3	110
AmBank (M) Berhad	AA3	1,000
DanaInfra Nasional Berhad	GG	3,240
Fortune Premiere Sdn Berhad	AA2	330
Gamuda Berhad	AA3	100
Bank Islam Malaysia Berhad	A1	300
Mah Sing Group Berhad	NR	145
Matrix Concepts Holdings Berhad	NR	100
OSK I CM Sdn Berhad	NR	170
Pac Lease Berhad	AA3	85
Pelabuhan Tanjung Pelepas Sdn Berhad	GG	240
Sarawak Energy Berhad	AA1	1,500
Southkey Megamall Sdn Berhad	NR	80
Projek Lintasan Sungai Besi-Ulu Klang Sdn Berhad	A1	540
Tiger Synergy Berhad	NR	10
Hap Seng Management Sdn Berhad	NR	500
Sunway Treasury Sukuk Sdn Berhad	NR	200
Malaysia Steel Works (KL) Berhad	AAA	130
		8,780

Source : Bloomberg, BPAM, HLB Research

There was a slight decrease in total fresh issuances of all ratings of Corp Bonds/Sukuk with the continuance of sizeable GG bonds amounting to RM3.2b by Danainfra Berhad following a lull period during June-Aug 2018.



Source : Bloomberg, BPAM, HLB Research

Outlook for December

Headwinds from tough local fiscal policies may emerge along with potential EM outflows. December expected to see less activity with liquidity drying up….

The average BTC for the two (2) auctions in November averaging 2.54x is strong testimony to the depth of the local govvies market compared to the average BTC of 2.29x for 2018 (2017:2.20x). At the time of writing both December's auctions of 20Y and 3Y GII auctions have been completed on impressive demand with the last two (2) auctions attracting 2.31x and 2.43x BTC respectively. We believe that attractive valuations are seen emerging as we continue to maintain our view that mild inflationary outlook i.e. replacement of GST with SST and the reintroduction of petrol subsidy for RON 95 and diesel will be contained due to moderating growth allowing BNM to keep OPR unchanged for the remainder of the year.

The Ringgit is seen to have stabilized at current levels following the lower 3Q GDP of 4.4% (2Q:4.5%) amid announcement of strong fiscal measures following the unveiling of the Malaysian Budget 2019 on 2nd November. The net federal deficit which was revised to RM53.2b or 3.7% of GDP (Note that this was originally increased from RM39.8b to RM40.1b) is expected to take a slight toll on local govvies and to a certain extent other financial assets as it takes cognizance of the one-off payment of both GST and Income Tax refunds of RM35.4b (via the assistance of a one-off dividend payment of RM30.0b from Petronas). The deferment of mega-infra projects like the ECRL, HSR, MRT3, Pan-Borneo highway and gas-pipeline projects whilst prudent is expected to complement the plugging of pilferage and excessive expenditures by government agencies. The outflows from EM's (as was the case in Aug-Sep period) due to tightening interest rate differential with the US may continue to haunt Malaysia as evident in the recent "zig-zag" movements in foreign holdings for Malaysian debt securities with November's data lower than October. Like-wise, ongoing global trade issues mainly between US and China continues to dampen appetite and may encourage fight-to-safety for UST's. The decrease of RM5.1b in foreign holdings of MYR govvies for November (despite no maturities in October versus gross issuances of RM6.0b for the 2nd consecutive month) was substantial.

We expect a relatively quiet December amid lack of liquidity from both local and foreign Institutional investor interest due to book-closing and lower manpower due to the annual leave requirements/year-end festivities. Nevertheless **values are seen in the 7Y and also the 15Y space while the 10Y seems rich at present values. Demand for Ringgit Corporate Bonds/Sukuk along the GG segment is strong and provides for a pick-up in yield compared to sovereign or other quasi-government papers i.e. Cagamas and Khazanah. However there is an apparent dearth of such issues. Likewise the AA-rated space i.e. infra and power related bonds continue to display decent values and an equally important factor i.e. liquidity.**

Fed dot plot indicates additional Fed rate hike in Dec…

The movement of US Treasury yields in November saw the curve flatten and move lower. Latest revisions for interest rate outlook in 2019 reveal Fed Dot Plot reduction of up to only three (3) rate hikes whilst the Fed Fund Futures is pricing in up to one and a half (1.5) rate hikes. Hence, UST's may find temporary relief. The continued swelling of debt issuance by the U.S. Treasury Department and the potential paring down of foreign holdings by China and Japan may weigh on yields. With a December rate hike almost a reality, US yield flattening is expected to resume as curve inversion has already begun to take place with the 2s5s and 3s5s spread flashing red. However a better recession predictor i.e. the 2s10s spread remains unchanged at 15bps this month. Ultimately, the likelihood of resolving the global trade checkmate is higher and risk assets may be back in favor for December 2018-January 2019 period. **Hence UST's could potentially rise; with the 10Y between 3.00-3.20% levels. The current yield curve is expected to maintain a flattened-bias unless the economy shows signs of under-estimation in inflation.** Rates may gradually move up on the back of sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2% objective over the medium term. **Negative duration i.e. short to intermediate duration portfolios (~2-5 years) may be favorable as shorter UST's now offer almost as much yield as the 10**Y **on lesser duration risk**. The downside risks to the above assumptions are the negative impact on global trade barrier issues especially pertaining to US-China and sudden emergence of geo-political issues (if any). **In the Credit/Corporate space, investors are expected to favor Investment Grade issuances which are deemed to be undergo less stress** instead of High Yield names, as these corporates are better-equipped to weather the test of global trade uncertainties and funding constraints.

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