Global Markets Research
Fixed Income

Monthly Perspective – June 2018

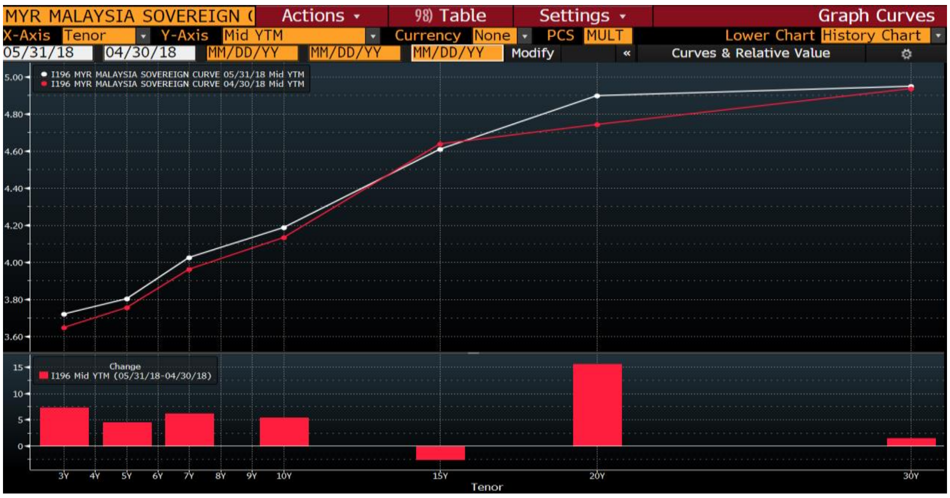
MYR Bond Market

Recapping the month of May

In the US, May saw lower inflation readings despite solid US payrolls; causing US Treasuries (UST's) to rally; thus reversing the losses seen the past two months. The front-end rates i.e. 2Y UST rallied closing 6bps lower at 2.43% following heightened levels prior to the FOMC rate hike last week. The dollar had gained ~ 2.0-2.5% against GBP and EUR in May with the Dollar Index maintaining its strength at ~93.30; allowing investors to focus on the yield advantage the US enjoyed over other countries. Receding fears of inflationary pressures saw the long-bond easing by 9bps to 3.03%. 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 2.79% and a high of 3.12% levels before closing lower similarly by 9bps 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 which flattened considerably by about 10-15bps earlier in April however saw more convexity in the shape of the curve in May with 2s10s spread tightening from 46 to 42bps whilst the 5s30s spread eased from 32 to 33bps.

On the local front, there were contrasting signals on volume for overall MYR bonds in May with foreign holdings continuing the earlier month's outflows on rising trade volume of R61.7b versus RM52.5b the prior month. The net outflows of RM12.9b M-O-M saw foreign holdings drop substantially to RM192.5b. The pull-back in foreign holdings to RM171.7b levels in both MGS and GII represents 24.9% of total outstanding MYR government bonds consisting of MGS+GII+SPK. (Apr: RM181.5b or 26.5% of total outstanding). Corporate Bonds/Sukuk however saw another marginal decrease of RM804m in foreign holdings to about RM14.3b. We note that MYR bonds notched higher trading volume for Govvies in May unlike for Corporate Bonds/Sukuk due to uncertainties related to GE14 and the threat of rising interest rates in US. Overall benchmark MGS yields spiked by 5-14bps MOM due primarily to outflows by foreign investors and inter-bank players with some support seen by local institutional investors. Both the 7Y MGS 3/25 and much-watched 10Y MGS 11/27 closed higher on yields at 4.02% and 4.18% respectively.

MYR sovereign curve (MGS)



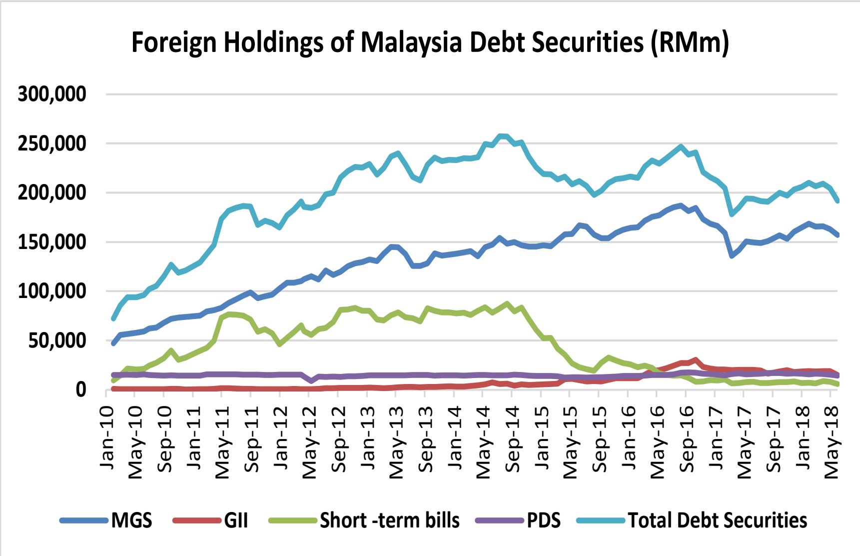
Source : Bloomberg

Strong headline NFP for May; wage gains and average hourly gains seen spurring frequency of Fed rate hikes

May Non-Farm Payrolls ("NFP") print rebounded strongly at 223k compared to market consensus of 190k. It was higher than April's 164k and the March low of 103k. Based on the solid jobs data, the unemployment rate dropped slightly further to a multiple year low of 3.8%. The quicker wage gains and average hourly earnings is seen to reinforce prospects of further interest rate increases in the US with near full-term employment seen over the horizon. These coupled with optimism over rising economic activity in the US; following the ongoing Tax Plan and Fed's balance sheet reduction/portfolio run-offs may lead investors to believe that inflationary pressures will cause the Federal Reserve to hike interest rates up to four (4) times for 2018 overall. (The first two were completed in March and recently in June). The downside to the above would be the re-emergence of trade tariff issues involving US-China or even with the other G-7 nations for that matter; potentially triggering a flight-to-safety bids for USTs. Separately, the recent meeting between Trump and Kim may have mitigated geo-political tensions to a certain degree.

Foreign Holdings of MYR bonds continued to nose-dive in May; generally trending downwards since beginning of 2018…

Foreign holdings of MYR bonds were lower for the second consecutive month of May with total holdings sharply down by RM12.9b or 2.2% to RM192.5b versus RM205.4b the previous month. The non-resident holdings of MGS dropped substantially by RM5.9b at RM156.9b; representing 41.9% of total outstanding) whereas total MYR Govt bonds (i.e. MGS+GII+SPK) holdings saw a sharp reduction of RM9.8b or 5.4% to RM171.7b (24.9% of total outstanding); the lowest month of foreign holdings for this year. Nevertheless the lowest and latest recorded was RM161.7b in April 2017.



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 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. Nevertheless The USDMYR came under some pressure off the 3.9400 levels 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. 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% compared to the previous growth forecast of 5.0-5.5%

MYR government bond auctions saw decent support for new benchmark issuance of 15Y MGS and 7Y GII reopening in May….

MGS/GII issuance pipeline in 2018

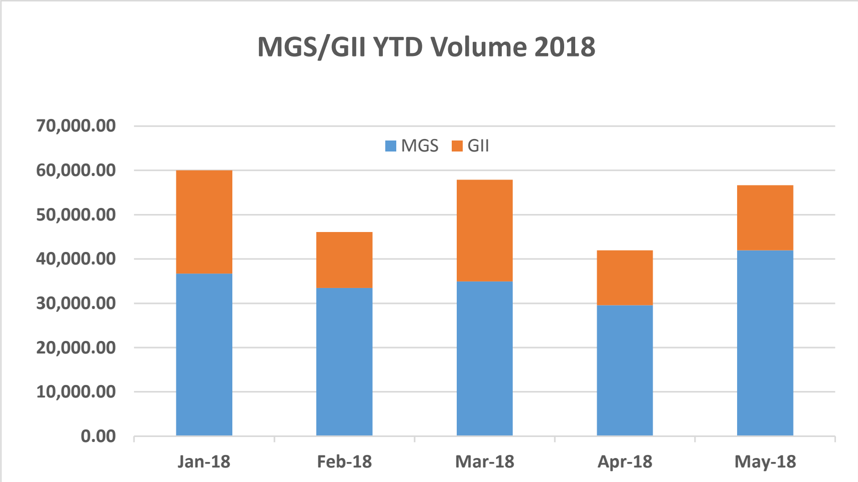
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Total Expected Size (RM mil)	Auction Issuance (RM mil)	Private Placement	Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	20-yr Reopening of MGS (Mat on 04/37)	20	Jan	Q1	4/1/2017	3,000	2,000	1,000	2,000	1.905	4.573	4.607	4.640	14.3%
2	5-yr Reopening 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	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		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	51,500	6,500						

Source: BNM, HLB Research

The four government bond tenders concluded for the month of May 2018 under the auction calendar included the new issuances of 5Y GII 11/23, 15Y MGS 11/33 and the also the reopening of 7Y GII 8/25, 10Y MGS 6/28 which altogether saw strong BTC support averaging 2.43x; higher than the 2.13x for all auctions the previous 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 2.23x for 2018). Tenders for the month were well received mainly by local followed by foreign investors. Worth noting was the 7Y new reopening of GII 8/25 on 14th May which saw a whopping BTC of 3.397x averaging 4.202%.

Trading volume for MGS/GII rebounded in May

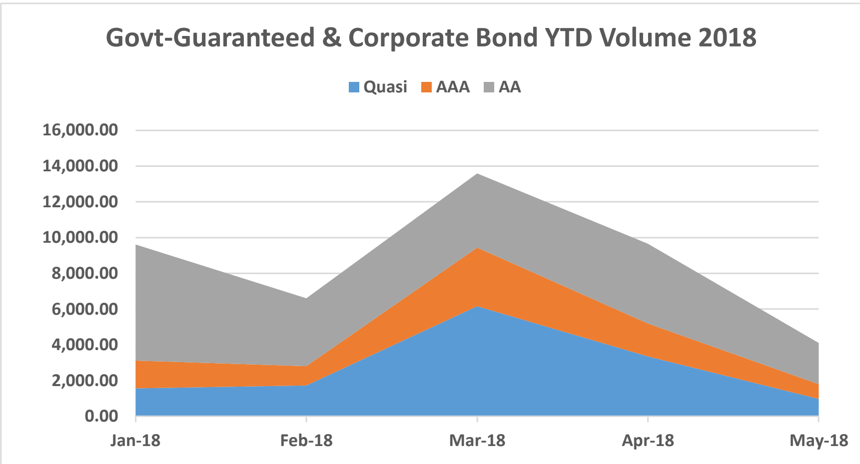
Trading volume for MYR govvies gained traction as volume from about RM41.9b in April to RM56.6b during May. The increase was seen across all tenures with substantial trades seen in the short to mid-tenured off-the-run 18-21's and also the MGS 4/33 which altogether topped frequency of trades for the month. Nevertheless offshore investors were mainly net sellers of ringgit government bonds on emerging market concerns arising from US rate hikes 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 south instead as volume halved from RM9.6b in April to RM4.1b in May. Investors were skewed again lower down the curve i.e. the AA-rated space with 56.3% market share of total trades (April: 46.2%) as investors looked for yield-enhancement opportunities whilst Govt-guaranteed bonds took a hit amidst the brouhaha over Govt's liabilities and its subsequent revision of late. Despite DANGA 30 topping the monthly volume; appetite remained on infra cum power-related bonds i.e. Southern Power, BGSM, YTL Power, MEX, DUKE, Malakoff etc. For ease of reference we have excluded single-A rated and non-rated papers in the following illustration.

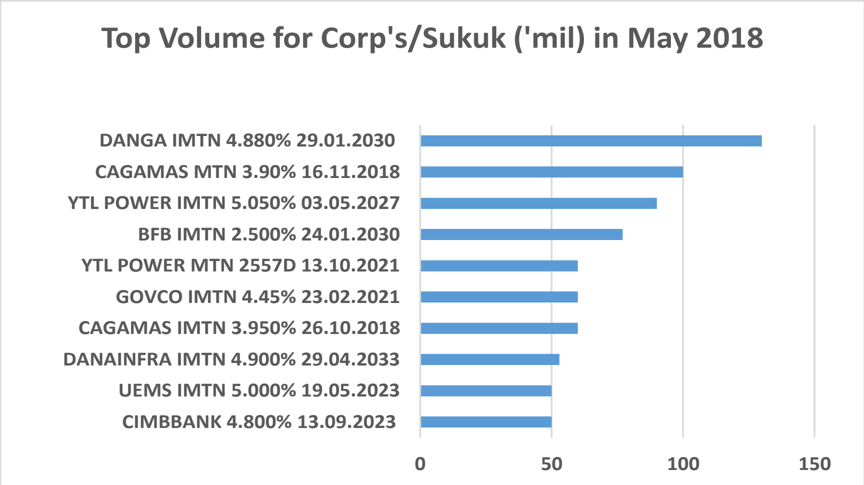


Source : BPAM, Bloomberg, HLB Research

Primary issuance print in May boosted by the following names:

Notable issuances for May-18	Rating	Amount Issued(RM mil)
Al-'Aqar Capital Sdn Berhad	AAA	220
Al-'Aqar Capital Sdn Berhad	AA2	23
Al-'Aqar Capital Sdn Berhad	NR	220
Al-'Aqar Capital Sdn Berhad	NR	112
CAGAMAS Berhad	AAA	1,500
DanaInfra Nasional Berhad	GG	2,500
Fenghuang Development Sdn Berhad	NR	29
Hektar Black Sdn Berhad	NR	32
KYS Assets Sdn Berhad	NR	5
KDU University College (PG) Sdn Berhad	NR	25
Kuantan Port Consortium Sdn Berhad	NR	650
Liziz Standaco Sdn Berhad	NR	9
OSK I CM Sdn Berhad	NR	200
Southkey Megamall Sdn Berhad	NR	50
Telekom Malaysia Berhad	AAA	250
UEM Sunrise Berhad	AA3	100
Yinson TMC Sdn Berhad	NR	950
		6,874

Source : Bloomberg, BPAM, HLB Research



Source : Bloomberg, BPAM, HLB Research

Outlook for June

New Govt swift in addressing concerns to fiscal policy but headwinds may persist due to narrowing of US-Asia interest rate differentials…

The strong BTC support for the four (4) auctions in May averaging 2.43x was higher than the 2.13x for all auctions the previous month and along with the average BTC of 2.20x for the entire of 2017. We maintain our view of softer inflationary outlook this year coupled with moderating growth and the return in real interest rate to positive territory; enabling 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; with surpluses seen and boosted by steady oil prices together with potential cut in government expenditures.

We expect a slight pick-up in liquidity for local govvies following clarity in new PH government's economic measures as evidenced by the revised fiscal deficit of additional RM300m to RM40.1b which literally allows for the 2.8% deficit to stay pat These confidence-boosting measures may neutralize the initial negative skepticism of policy decisions. Nevertheless we are aware of external headwinds due to US-Asia interest rate differentials followed by the mid-year school break and the major Wprld Cup event extending from mid-May to mid-June. Meantime demand for Ringgit Corporate bonds may hinge on revision/changes to Terms and Conditions awarded in major privatized and other infra-related projects i.e. highways, power-plants etc by the previous govt. Hence these may require thorough credit assessments and portfolio adjustments.

Fed dot plot of additional two additional Fed rate hikes for 2018 is on the cards; making it a total of four for 2018….

The recent stability and lower US Treasury yields in May was a relief and far cry from the volatilities in the Fixed Income market the prior month due to rising wage costs and inflationary pressures.

However the Fed's revised "dot plot" due to the strong US economy 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. In addition, the ongoing pace of balance sheet reduction by the US Fed may continue to impact US Treasuries yields in the month of May. Investors may be sidelined and digest the potential of another two (2) Fed rate hikes for 2018. Whilst net foreign holdings decreased to $4.8b in April; one cannot discount the possibility of portfolio capital inflows from two of the largest holders of UST's i.e. China and Japan if yields display attractiveness and stability.

The downside to our view is the easing of geopolitical tensions following the Trump-Kim meeting yields coupled with the potential flight-to-safety characteristics due to renewed trade barriers between US-China.

The much-watched UST 10Y which flirted briefly above 3.00% again; is stable at 2.90% levels at the time of writing and is expected to stabilize around the 3.00% area. 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 economy may be showing signs of under-estimation in inflation. 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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