Global Markets Research
Fixed Income

Monthly Perspective – September 2019

MYR Bond Market

Recapping the month of August

US Treasuries (UST's) rallied on massive buying in August after the 25bps rate cut by the Fed at its FOMC meeting on 31st July as investors flocked to the safe-haven assets following the escalation in US-China trade tensions. Other risks and concerns over the horizon include trade tariffs, slowing global growth, Brexit and geopolitical ones such as Hong Kong protests, India-Pakistan stand-off etc. Benchmark **UST yields reversed prior month's trend; ending lower between 36-56bps.** The UST yield curve bull-flattened as the front-end UST 2Y yield rallied a massive 36bps MOM at 1.51% levels whilst the 10Y, which depicts as a benchmark for US mortgage rates and inflation, saw greater volatility in August; ranging between 1.47%-2.01% levels and declined 50bps at 1.50%. The yield curve finally inverted with both front-end spreads i.e. 3m10s and the 2y10y @ -49bps and -2bps respectively. The US Dollar meanwhile was a clear winner as it advanced against all G10 currencies, with the Dollar Index charging to 98.9 levels; highest since the peak during late 2016-early 2017 period. (At the time of writing: 98.4). US NFP for August left markets with mixed signals punctuated with fewer jobs than expected (i.e. 130k versus 160k) while wage growth rose.

On the local front, **MYR govvies** saw foreign holdings somewhat flat in August following two straight months of increases in June and July. Secondary market volume rallied to RM102.3b (July: RM79.8b) due to continued demand for yield-carry and also safe-haven bids mainly by both onshore and offshore real money amid global trade and growth concerns. Foreign holdings of total MYR bonds was down by an almost negligible RM100m MOM to RM188.2b; as opposed to prior month's increase of RM5.8b. The percentage of foreign holdings of MYR government bonds (MGS + GII + SPK) however fell to 22.8% or RM169.0b of total outstanding issuance. (July: RM169.4b or 23.0%). **Overall benchmark MGS/GII bonds rallied further with yields down between 2-30bps.** The 5Y MGS 4/23 declined 20bps lower at 3.23% whilst the much-watched 10Y MGS 8/29 rallied 25bps lower from 3.57% to 3.32% levels. Corporate Bonds/Sukuk however saw levels of foreign holdings maintain at ~RM11.9b since April as bulk of holdings remain with institutional investors comprising pension funds, insurance companies and asset management companies amid a spike in secondary market volume of RM17.7b in August.

MYR sovereign curve (MGS)

Source : Bloomberg

Lackluster NFP data in August creates insufficient vigor for a continued rally in bonds despite a looming potential rate cut…

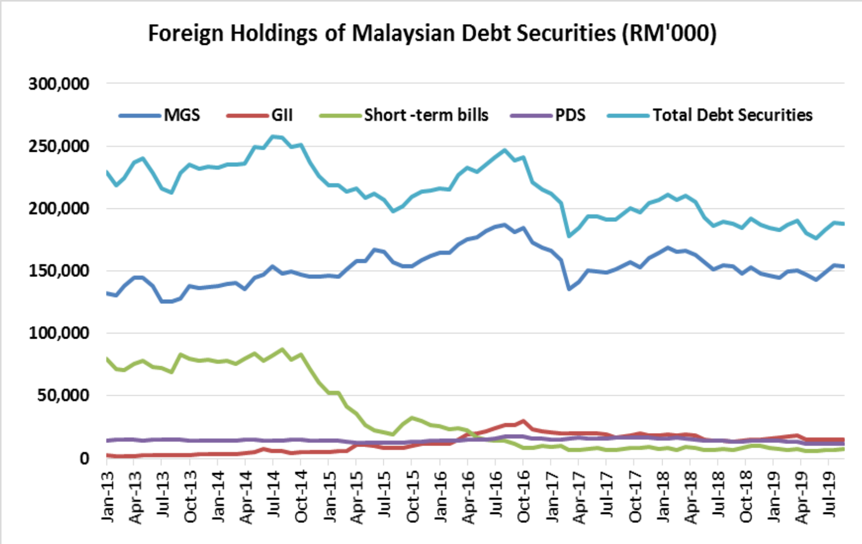
August Non-Farm Payrolls ("NFP") of 130k did disappoint market expectations of 160k. The concern that 30k of those jobs were temporary ones assisting the Census along with downward revisions of 20k for the prior two months did not dampen the still-growing labor market which showed a silver lining. We note that the unemployment rate has held steady at a 50-year low of 3.7% and believed to be largely attributable to the decent participation rate of 63.2% which was also slightly higher by 0.2% for the month. This along with the continued decent print on average hourly wages of +0.4% MOM as opposed to consensus (previous month: +0.3%) and +3.2% YOY (previous month: also +3.2%) was a key contrast that would cause the Fed to re-assess the lower interest rate outlook.

To re-cap, the Fed cut rates by 25bps to 2.00-2.25% as widely expected in its July FOMC meeting; a turning point for global monetary policy. It is believed that the Fed left the door open for additional easing despite the current (June) **Fed's dot plot reflecting a status-quo stance** on interest rate outlook for 2019. However the **market odds (via readings from the Fed Fund Futures)** indicate certainty of a 25bps **rate cut in September with a total of up to 50bps cuts by December** according to a Bloomberg survey whilst CME Fed Watch Tool reflects a 92% chance of a 25bps rate cut instead. The Fed appears keen to continue easing monetary policy in an effort to combat political angst that's creating an uncertain economic outlook and has flattened the yield curve. However, it may take easing more than what's priced into the market for curves to un-invert. The Fed is also poised to start increasing its balance sheet again, but it won't be full-blown quantitative easing. Domestic inflation remains muted; whilst wages are rising; yet not enough to put pressure on inflation. The Fed's **preferred inflation measure** for July i.e. the personal consumption expenditure (PCE) core index for both MOM and YOY **maintained at 0.2%** and **1.6% respectively;** (the core index which strips out the volatile food and energy costs is a better gauge of future developments) This may indicate that the core CPI for July could challenge the Fed's view that a return to its 2.0% inflation target will take longer than envisaged. Meanwhile, the Fed had concluded its "balance sheet normalization" much earlier in August last month having started in October 2017, to ensure an easier monetary policy. The UST holdings by the Fed of about $2.09 trillion is poised to rise as the Fed may start increasing its balance sheet again as mentioned above.

Foreign holdings of overall MYR bonds seen flattish in August….

Foreign holdings of MYR bonds eased marginally by a mere RM89m or negligible 0.05% in August to RM188.2b. The non-resident holdings of MGS decreased RM1.0b from RM154.7b to RM153.7b (representing 37.7% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw a slight dip of RM400m to RM169.0b (representing 22.8% of total outstanding) amid net issuances of RM4.0b for the month (July: RM2.1b). Hence the larger drop in percentage holdings compared to absolute change in amounts.

The US Treasury Department's Semi-Annual Currency report in May that placed Malaysia on the US Treasury's Monitoring List followed by news in April on FTSE Russell index's possible change in the weightage of MYR bonds come end-September may raise concern for investors despite the steady holdings in foreign holdings and positive performance of MYR bond asset class. YTD overall, both MYR bonds saw a net drop in foreign holdings to RM3.4b but a bigger slide in net equity outflows of RM7.3b respectively in the first eight (8) months of 2019. On the currency side, the MYR weakened by almost 2.0% at 4.2055 levels as at end-August and also against most Asian currencies. However at the time of writing, USDMYR is trading at 4.1730 amid dollar weakness.



Source: BNM, HLB Research

OPR stays pat as MPC undertone remains neutral due to confidence in broad-based sectoral expansion, stable labor market and wage growth and higher inflation…

BNM maintained the OPR at 3.00% at the 5th MPC meeting of the year on the 12th of September, stating monetary policy remains accommodative and supportive of economic activity. The MPC will continue to assess the balance of risks to domestic growth and inflation. (Note: The last policy move was a 25bps cut in May 2019). **Our full year estimate for 2019 GDP growth remains unchanged at 4.7% levels** (1Q2019: 4.5%; 2Q2019: 4.9%) supported by continued moderate growth in domestic demand. However the risks to our projections are; worsening external environment that may pose a greater risk to an OPR pause. Hence, protracted downside risks to growth imply the door for further policy easing is not completely closed as much depends on the evolvement of risks and financial conditions. Any imminent Fed rate cut(s) could raise the odds of another adjustment in the OPR should domestic growth weaken more than expected. The current level of rates has seen MYR bonds rally; thus allowing existing portfolio investors to reap gains.

MYR government bond auctions saw strong demand in Aug for the 5Y GII and 20Y MGS bonds….

The three (3) government bond tenders concluded for the month of Aug 2019 under the auction calendar included re-openings for the 5Y GII 10/24 that saw the 2nd highest YTD bids totaling RM12.4b which resulted in an impressive BTC ratio of 4.137x; followed by the reopening of the 20Y GII 6/38 (BTC ratio: 3.15x). However the 3rd and final tender for the month saw muted response for the 10Y GII 7/29 (BTC ratio: 2.00x). Overall weighted average BTC for the month **improved to~ 3.10x** mainly due the strong 5Y GII auction. This is commendable when compared to both the YTD BTC ratio of 2.74x and also the entire 33 auctions for 2018 which notched a BTC ratio of 2.29x. Tenders for the month received strong bids from mainly local institutional investors followed by offshore foreign inter-banks and institutions. At the time of writing investors were awaiting the reopening of 7Y MGS 7/26 this month.

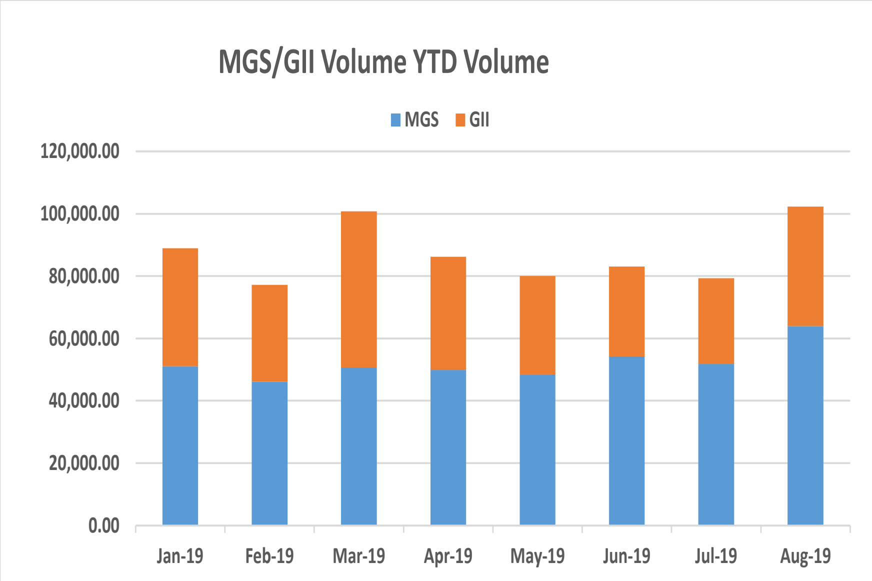
MGS/GII issuance pipeline in 2019

No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Projected Issuance Size (RM mil)	Actual Auction Issuance (RM mil)	Private Placement	Auction Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	10.5-yr New Issue of GII (Mat on 07/29)	10	Jan	Q1	8/1/2019	4,000	3,500	1,500	3,500	4.067	4.110	4.130	4.135	86.1%
2	7.5-yr New Issue of MGS (Mat on 07/26)	7	Jan	Q1	14/1/2019	4,000	3,500	500	7,000	2.216	3.890	3.906	3.914	8.2%
3	5-yr Reopening of GII (Mat on 11/23)	5	Jan	Q1	30/1/2019	3,500	4,000		11,000	1.974	3.845	3.862	3.873	19.0%
4	10.5-yr New Issue of MGS (Mat on 08/29)	10	Feb	Q1	14/2/2019	4,000	4,000	1,000	15,000	2.536	3.867	3.885	3.893	31.6%
5	15-yr Reopening of GII (Mat on 06/33)	15	Feb	Q1	27/2/2019	3,000	2,000	1,000	17,000	3.906	4.360	4.370	4.375	33.9%
6	3-yr Reopening of MGS (Mat on 03/22)	3	Mar	Q1	7/3/2019	3,500	3,000		20,000	3.132	3.470	3.483	3.487	70.0%
7	20.5-yr New Issue of GII (Mat on 09/39)	20	Mar	Q1	14/3/2019	4,000	2,500	2,000	22,500	2.758	4.445	4.467	4.480	14.5%
8	30-yr Reopening of MGS (Mat on 07/48)	30	Mar	Q1	21/3/2019	3,500	2,000	2,000	24,500	1.718	4.550	4.591	4.629	25.0%
9	7-yr New Issue of GII (Mat on 03/26)	7	Mar	Q1	28/3/2019	4,000	4,000		28,500	2.330	3.699	3.726	3.745	21.2%
10	15-yr Reopening of MGS (Mat on 11/33)	15	Apr	Q2	5/4/2019	4,000	2,500	1,000	31,000	2.792	4.058	4.065	4.071	40.0%
11	5.5-yr New Issue of GII (Mat on 10/24)	5	Apr	Q2	12/4/2019	4,000	3,500		34,500	2.313	3.627	3.655	3.669	64.7%
12	7-yr Reopening of MGS (Mat on 07/26)	7	Apr	Q2	29/4/2019	3,000	3,500	500	38,000	1.510	3.735	3.757	3.777	75.0%
13	30.5-yr New Issue of GII (Mat on 11/49)	30	May	Q2	14/5/2019	3,000	2,000	2,000	40,000	3.298	4.625	4.638	4.663	100.0%
14	10-yr Reopening of MGS (Mat on 08/29)	10	May	Q2	23/5/2019	3,500	4,000		44,000	1.840	3.810	3.836	3.852	22.0%
15	15.5-yr New Issue of GII (Mat on 11/34)	15	May	Q2	30/5/2019	4,000	2,500	1,500	46,500	3.380	4.105	4.119	4.126	44.4%
16	5-yr New Issue of MGS (Mat on 06/24)	5	Jun	Q2	13/6/2019	4,000	4,000		50,500	2.489	3.466	3.478	3.484	8.3%
17	20-yr Reopening of GII (Mat on 09/39)	20	Jun	Q2	27/6/2019	3,000	2,000	2,000	52,500	4.275	4.070	4.074	4.079	59.1%
18	15-yr New Issue of MGS (Mat on 07/34)	15	Jul	Q3	4/7/2019	4,000	3,500		56,000	3.437	3.805	3.828	3.835	73.5%
19	7-yr Reopening of GII (Mat on 3/26)	7	Jul	Q3	12/7/2019	3,000	3,000	500	59,000	2.874	3.568	3.582	3.586	70.0%
20	30-yr Reopening of MGS (Mat on 07/48)	30	Jul	Q3	26/7/2019	2,500	2,000	1,500	61,000	2.490	4.170	4.181	4.208	100.0%
21	5-yr Reopening of GII (Mat on 10/24)	5	Aug	Q3	8/8/2019	3,500	3,000		64,000	4.137	3.329	3.345	3.349	10.7%
22	20-yr Reopening of MGS (Mat on 06/38)	20	Aug	Q3	14/8/2019	3,000	3,000	1,000	67,000	3.150	3.745	3.753	3.758	81.1%
23	10-yr Reopening of GII (Mat on 7/29)	10	Aug	Q3	29/8/2019	3,500	3,000		70,000	2.000	3.290	3.318	3.330	80.0%
24	7-yr Reopening of MGS (Mat on 07/26)	7	Sep	Q3		3,500								
25	15-yr Reopening of GII (Mat on 11/34)	15	Sep	Q3		3,000								
26	10-yr Reopening of MGS (Mat on 08/29)	10	Oct	Q4		3,000								
27	20-yr Reopening of GII (Mat on 09/39)	20	Oct	Q4		2,500								
28	5-yr Reopening of MGS (Mat on 06/24)	5	Oct	Q4		3,500								
29	3.5-yr New Issue of GII (Mat on 05/23)	3	Nov	Q4		4,000								
30	20.5-yr New Issue of MGS (Mat on 05/40)	20	Nov	Q4		4,000								
31	10-yr Reopening of GII (Mat on 07/29)	10	Nov	Q4		3,000								
32	15-yr Reopening of MGS (Mat on 07/34)	15	Dec	Q4		3,000								
	Gross MGS/GII supply in 2019					101,000		18,000						

Source: BNM, HLB Research

Trading volume for MGS/GII ramped up in August…

Trading volume for MYR govvies i.e. MGS + GII bonds spiked to ~RM102.3b in Aug compared to prior month's RM79.8b. Interest was seen across the curve including the longer ends late in the month with substantial and frequent trades done in the off-the-run 19-21's (forming ~RM6.2-6.4b for each tenor or forming ~20% of overall volume). This was followed by both the 3Y and 5Y benchmarks (forming between RM8.1-8.7b each i.e. 16% of total trades) and 10Y benchmarks (forming higher amounts of RM5.8b or ~6% of total trades). The month under review continued to see interest boosted further in the long-ends in both the 20Y MGS 6/38, 20Y GII 9/39 and 30Y MGS 7/48 benchmarks which saw higher volumes of ~RM6.6b in total (July:RM6.1b) as investors opted to long duration. Both local institutional investors/offshore parties were equally active and remained net buyers for MYR govvies in August as yields ended richer between 15-41bps across the curve as the appeal of safe-haven assets whipsawed across the investing community amid dovish-tilt bias by global central banks.



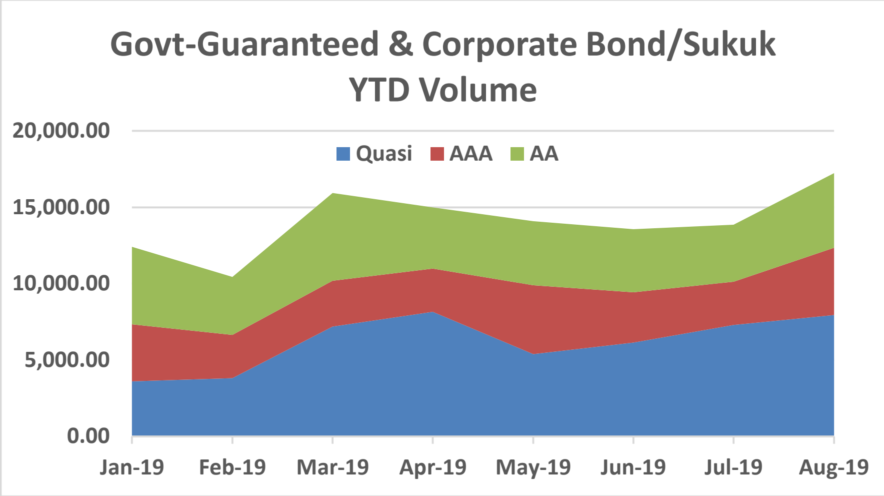
Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk continue to see solid demand…

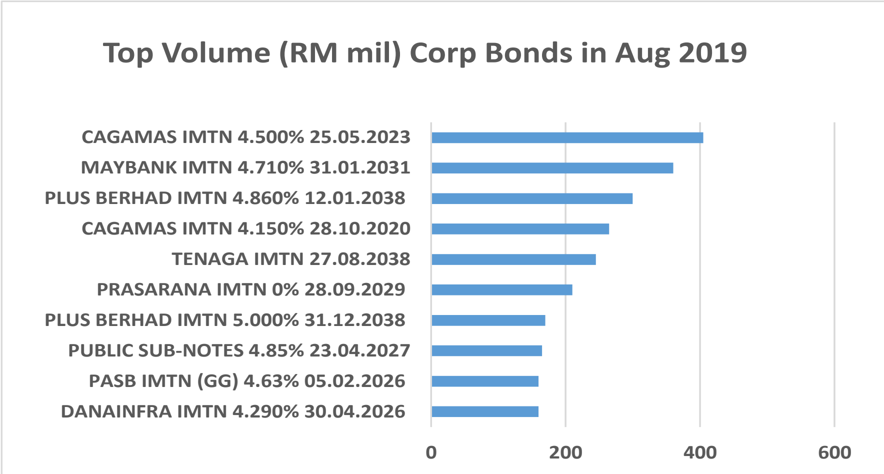
In the secondary market, Corporate Bonds/Sukuk (including Govt-Guaranteed bonds for our ease of classification) saw strong secondary market trading volume on improved momentum as volume notched ~ RM17.7b in August; an 18% increase compared to RM14.4b the prior month. Solid demand from local fund managers/portfolio investors was apparent with active bids/offers in the secondary market; causing yields to continue declining lower yet again up to 40bps for quality credits rated AA and above. The elevated global trade tensions and anticipated slowdown in global growth continued to ignite the bond rally thus sparking a spillover higher up the curve into Corporate Bonds/Sukuk in August.

Investor appetite for GG saw strong traction again MOM; despite a drop to 46% in August (July: 57%) due to a larger overall volume from both AAA and AA sub-classes. AAA-rated bonds as a percentage of overall transactions rose from 20% to 26% due to government's commitment to cap its debt obligations of GG and also stickiness of these sought-after bonds for the month. AAA-rated CAGAMAS 5/23 and MAYBANK 31NC26 topped the monthly volume; closing between 36-40bps lower at 3.35% and 3.88% respectively for the month compared to previous-done levels. This was followed by a GG bond i.e. long-end PLUS 1/38 and another tranche of CAGAMAS 10/20 which declined a whopping 52bps and 15bps respectively at 3.72% and 3.30% respectively.

Appetite in the credit space was seen in a wide range of bonds namely conglomerates, infrastructure-related names including telecommunication, toll and energy sub-sectors. AAA-rated TELEKOM 23-27, PLUS 23-37, TENAGA 32-38, SARAWAK HIDRO 20-30, GENM CAPITAL 23-33, DANGA Capital 20-33 together with AA-rated KESTURI 22-29, JEP 27-32, SEB 21-36, EDRA Energy 22-38 and YTL Power 21-27 also continued to see active trading. In the banking space, decent frequency of trades were noticed for both BANK ISLAM and Bank Pembangunan bonds. (Note: we have excluded single-A rated and non-rated papers in the illustration below).



Source : BPAM, Bloomberg, HLB Research



Source : BPAM, Bloomberg, HLB Research

Primary issuance print in August boosted by the following names:

Notable issuances in Aug-19	Rating	Amount Issued (RM mil)
Cagamas Berhad	AAA	1,225
Chellam Plantations (Sabah) Sdn Berhad	NR	5
Dynamic Gates Sdn Berhad	NR	109
Damansara Uptown Retail Centre Sdn Berhad	NR	22
Eco World Capital Assets Berhad	NR	250
Fenghuang Development Sdn Berhad	NR	5
Hap Seng Management Sdn Berhad	NR	300
Konsortium KAJV Sdn Bhd	AA3	85
Liziz Standaco Sdn Berhad	NR	17
Malayan Banking Berhad	AAA	25
Paramount Corporation Berhad	NR	100
Prasarana Malaysia Berhad	GG	850
Puncak Wangi Sdn Berhad	AAA	45
Sabah Development Bank Berhad	AA1	500
Sabah Development Bank Berhad	AA1	200
Sunway Treasury Sukuk Sdn Berhad	NR	160
Telekosang Hydro One Sdn Berhad	A2	120
Telekosang Hydro One Sdn Berhad	AA3	470
Touch Mobile Sdn Berhad	NR	50
Xinghe Holdings Berhad	NR	10
YNH Property Berhad	NR	263
		4,811

Source : BPAM, Bloomberg, HLB Research

Total fresh issuances of all ratings of Corp Bonds/Sukuk dropped to ~RM4.81b (July: RM6.90b due to lesser quasi-government issuances by GLC's and banks. However, there were two prominent bond issuances consisting of PRASARANA (GG) 15y and 20Y totaling RM850m with coupons ranging from 3.92-4.09%. This was followed by CAGAMAS Berhad's 1-3Y papers amounting to RM1.225b and Sabah Development Bank's RM700m AA3-rated 6Y bonds with coupon of 4.55%

Outlook for Sep

Investors will have to re-assess expectations of dovish environment that may impinge on bond yields…

The weighted average BTC for the three (3) auctions in August rose to a solid 3.10x (July: 3.02x). The MYR bond market saw strong demand and was well-bid; and is expected to hold well on appeal of safe-haven assets; following the trend in many EM and global bond markets. We note that **BNM's continued decision to stay pat on the OPR at the September MPC meeting** (last change involved a 25bps cut in May). was premised on the resilience of private spending alongside stable labor market and wage growth are expected to remain supportive of the economy activity and expect the nation's diversified exports to mitigate the impact of softening global demand. The neutral statement also said that the current stance of monetary policy remains conducive to sustainable growth amid price stability whilst a close watch will be maintained on the balance of risks to domestic growth and inflation. Although the USDMYR pair has strengthened to 4.1730 levels at the time of writing from recent 4.2000 levels end of last month; this is a result of both MYR strength coupled with USD weakness. Nevertheless **concerns remain over the addition of Malaysia by FTSE Russell on the watch list for potential change in its World Government Bond Index (WGBI) weightage at the end of this month.** This could pose risk of outflows of up to US$4 billion by passive funds and an additional US$2-4 billion by active funds, should FTSE Russell exclude Malaysian bonds entirely. However we opine that the likely scenario will encompass a reduction of Malaysia weightage instead to accommodate China's inclusion into the World Government Bond Index (WGBI). Based on the above, MYR bonds are expected to see slight weakness until the above-mentioned hurdles are resolved and depends upon ongoing efforts by regulators to deepen and provide stronger liquidity in both Bonds and MYR. Hence **we expect yields to drift sideways-to-higher levels in September.**

Kinks within the curve reveal both the 5Y and 15-20Y space for MGS/GII bonds offering some values whilst the 10Y space are not compelling buys at this juncture. We note that there is a higher amount of maturities i.e. RM6.0b worth of maturities for MYR govvies in August (July: RM8.6b). Demand for Ringgit Corporate Bonds/Sukuk along the GG segment do not look compelling at 5-15bps spreads over MGS but will continue to attract enquiries considering supply constraints and lesser slippage on portfolio requirement and guidelines. We continue to expect spillover down the yield curve with both the AAA and AA-part of the curve garnering attention with interest spanning into liquid utilities, energy and toll-related names.

Markets pricing in another two (2) more Fed rate cuts this year…

The UST movements in August saw the curve flatten with the UST 10Y seeing a more volatile trading range of 54bps (July: 45bps) as the bond market rallied strongly form 5Y tenures extending outwards. This bond rally trend was seen across global bond markets as well on expectations interest rate cuts by the Fed and other central banks. Meanwhile both US and China are expected to resume trade talks in September. President Trump will delay the imposition of an extra 5% tariff on $250 billion in Chinese imports from 1st October to 15th October whilst China announced a range of US goods to be exempted from the 25% extra tariffs enacted last year.

While average monthly job gains of 158k this year are down sharply from 223k in 2018, the pace is possibly sufficient to be in line with population growth. Also, the jobless growth is near a 50-year low and wage growth has outpaced labor growth. However inflation expectations together with the outlook for looser monetary policy may keep the bond bears away for now. The Fed will be looking at economic growth, job creation, wages and inflation whilst keeping an eye on unresolved trade issues with China and events like BREXIT. UST's are expected to find support under the current scenario for 2019 amid muted inflation and softer global growth. The US yield curve briefly flirted with inversion in August but reverted to a positive spread and will continue to be closely monitored as a recession predictor.

The case for a rate cut versus no cut is still tilted to the former based on low and muted inflation, global uncertainties on economic growth due to trade-related issues and also dovish-Fed dissenters including updated Dot Plot projections. The other matter that cannot be ignored is the geopolitical situations involving Hong Kong, India-Pakistan, etc. We are still neutral on UST's as market expectations of the Fed easing may be deemed excessive. **We view the shorter-end to be particularly vulnerable. Whilst the US yield curve continues to flirt into and out of inversion, we foresee the longer-term maturities as an effective tool against a risk asset sell-off. The 10Y is expected to range between 1.65-1.85% whilst finding support at 1.85% levels.**

In the Credit/Corporate space, Investment grade (IG) debt may well see red flags appear due to potential stalling in the global economy; with profit margins that may prove challenging. In addition to cutting duration, we opine that boosting the credit quality of his portfolio will minimize risk. Similarly, at this late stage of the cycle, it may not be feasible to be reaching for yield by increasing credit risk, and consequently prefer to keep credit quality high and spread duration low. We continue to prefer avoiding the HY sector due to potential stretched balance sheets.

Investors may still find IG issuances that offer decent spreads of ~ 110bps and above amid a tumultuous month in August as YTD returns hit 12% (reference is made to the Bloomberg Barclays US Aggregate Index for Investment-grade corporate bonds) The easier monetary policy to date has helped sustain the business cycle with less stress.

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