March 13, 2019

# Global Markets Research

## Fixed Income

# *Monthly Perspective – March 2019*

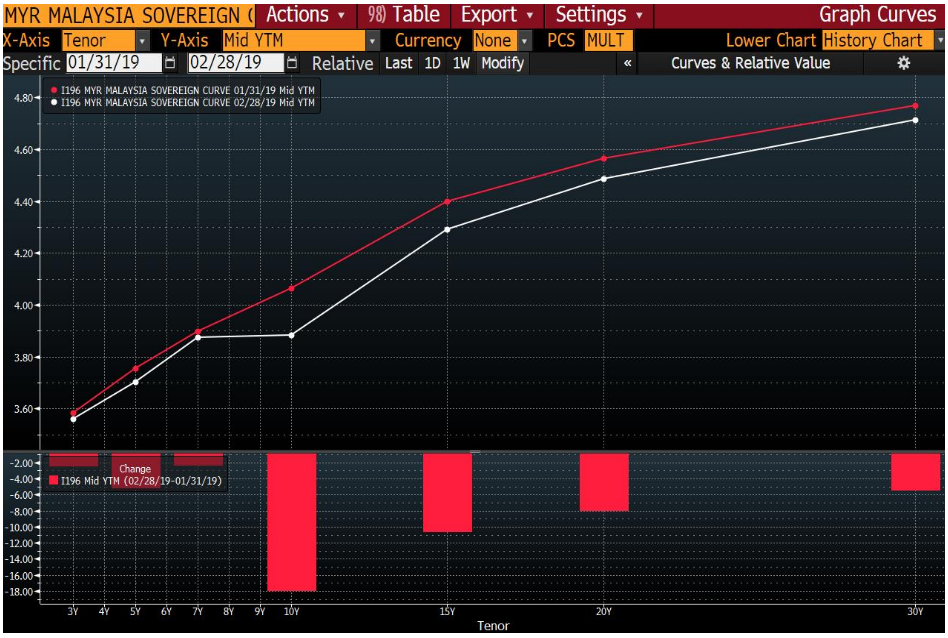
## *MYR Bond Market*

## *Recapping the month of February*

***US Treasuries (UST's)*** *saw a reversal with yields edging higher between 6-9bps as the curve shifted higher with most gains given up in the 10Y sector following upward pressure from ISM Manufacturing, CPI data and IG credit issuance; and downward pressure from retail sales data. The massive fall in US payrolls for February was partly offset by other solid supporting jobs data instead. The front-end rates i.e. UST 2Y yields rose 6bps to 2.52% levels whilst the 10Y, which depicts as a benchmark for US mortgage rates, borrowing costs for municipalities and also inflation indicator, saw less volatility in February as it oscillated between a low of 2.63% and a high of 2.72% levels before closing 9bps higher MOM at 2.63%. The dollar had ended 0.4-2.5% stronger against all G10 currencies (save for GBP) whilst the Dollar Index edged higher to 96.2 levels. The UST yield curve saw a slight steepening bias, as the 2s10s spread rose 2bps to about 19bps whilst the 5s30s spread edged a mere 1bp to 57bps.*

*On the local front,* ***MYR bonds*** *saw a pleasant rise in foreign holdings in February compared to prior month's decrease amid a robust and enormous secondary trade volume of RM92.7b (Jan:RM103.1b) amid a shorter trading month. The foreign holdings jumped by RM4.5b MOM to RM187.0b, reversing outflows in the last three months. The percentage of foreign holdings of MYR government bonds spiked to 22.7% or RM166.7b of total outstanding MYR Govvies consisting of MGS+GII+SPK. (Jan: RM161.0b or 22.2%). Overall benchmark MGS/GII bonds yields ended lower with most tenures lower between 2-18bps. The 5Y MGS 4/23 rallied 4bps at 3.72% whilst the much-watched and newly-issued 10Y MGS 8/29 saw a 16bps rally from 4.05% to 3.89% levels. (The 10Y has breached the 4.00% support followed by 3.90% threshold for the first time since April 2018). Corporate Bonds/Sukuk saw a marginal drop of RM366m in the levels of foreign holdings at RM13.5b. Local institutional investors were still net buyers causing yields to grind lower on solid demand.*

***MYR sovereign curve (MGS)***




*Source : Bloomberg*

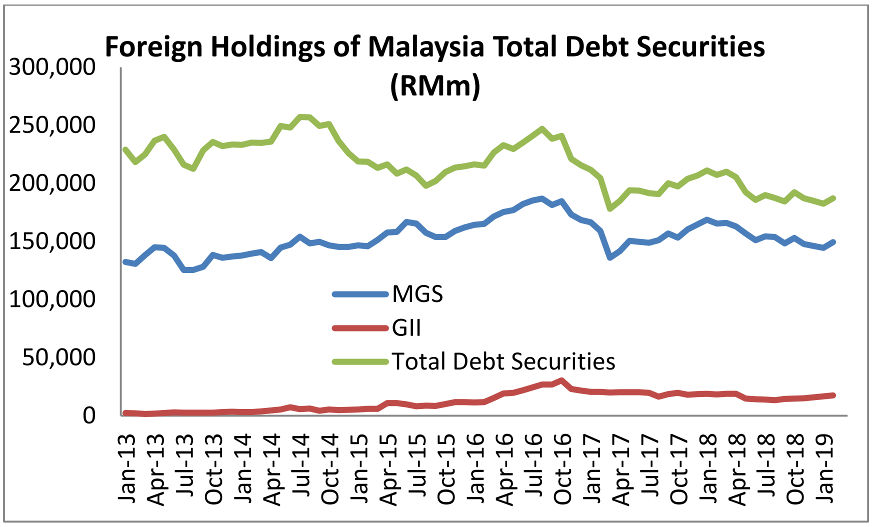
### *Weak NFP in February sticks out like a sore thumb; a stark contrast compared to other solid supporting jobs data…*

February Non-Farm Payrolls ("NFP") surprised on the downside by the printing of a mere 20k compared to market consensus of 180k (Jan: revised upwards from 304k to 311k) pointing to a softer labor market on the surface. This was mainly due to falls in construction employment whilst jobs were however added in professional and business services, healthcare and wholesale trade. However the unemployment rate improved from 4.0% to 3.8% mainly reflecting the return of federal workers who were furloughed in January due to the partial government shutdown. Participation rate maintained at the 5-year high of 63.2% which denotes confidence in job prospects. Likewise hourly wages roared 0.4% MOM (previous: +0.1%), a strong gain than the prior month and surpassed expectations. That backs the Fed's more patient approach with interest rates at least for the first quarter or even first half of 2019. Data is being closely monitored by the Fed for continuance of evidence of diminishing slack in the labor market and upward pressure on inflation. The current Fed's dot plot supports the case for two (2) interest rate increases for 2019 with the next policy-meet on 20th March.

At the time of writing, the US central bank said in its March FOMC statement that it was willing to be patient and take a dovish stance amid easing financial conditions and rising stock market whilst the labor market has continued to remain solid based on most jobs indicators mentioned above. Economic activity still maintained its momentum. After revisions, the average pace of employment growth is commendable and its preferred inflation measure for February i.e. the core CPI was little changed i.e. rising a mere 0.1% MOM (Jan: 0.2%) and 2.1% YOY (Jan: 2.2%). Softer fuel prices contributed to the muted impact on inflation towards the economy the past month. Tax reform-specific cuts, government additional spending which has helped accelerate economic growth, combined with the Fed's balance sheet run-offs (from RM4.5 trillion to RM4.0 trillion currently) has yet to reignite inflationary pressures and rates are still stubbornly fastened within ranges seen the past two (2) months.

### *Foreign holdings of overall MYR bonds spiked in February on stronger momentum and demand for MYR assets…*

Foreign holdings of MYR bonds saw a reversal of the previous three (3) months of decline with February's total foreign holdings higher by RM4.5b or 2.5% to RM182.5b. The non-resident holdings of MGS was substantially higher by RM4.9b to RM149.3b; representing 38.3% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw bigger increase of RM5.7b or 3.5% to RM166.7b due to the slight increase in GII bond holdings. This represented 22.7% of total outstanding; off the lowest level of foreign holdings in nearly two (2) years.




*Source: BNM, HLB Research*

### *Second MPC for the year sees OPR stay pat at 3.25% on lower inflation & growth concerns…*

BNM maintained the OPR at 3.25% at the second MPC meeting of the year on 5th of March amid deflationary conditions in January for the first time since 2009 (largely led by lower fuel and transport costs) whilst recognizing downside risks in the economic growth outlook for 2019. The last policy move was a 25bps hike in January last year and the last rate cut was in July 2016. The central bank reiterated that inflation is expected to remain low in the intermediate term due to policy measures including a lower price ceiling on domestic retail fuel prices until mid-2019, and the impact of the changes in consumption tax policy on headline inflation. Lower rates would allow existing investors to potentially reap rewards but also diminish the yield appeal of MYR bonds by fresh investors; hence a delicate balance will have to be struck. Nevertheless the latest issuance of Samurai Bonds was successfully placed out at a lower coupon of 0.55% compared to earlier 0.65% projection. The ongoing demand for EM assets has enabled Malaysia to benefit from foreign portfolio inflows in February with strong foreign and local institutional demand. MYR bonds saw a net increase in foreign holdings of RM2.2b while equities saw a net inflow of RM0.2b YTD February. On the currency side, the USDMYR continued to see MYR strengthen further ~0.8% at 4.0658 levels as at end-February, in tandem with appreciation against most other Asian currencies. At the time of writing, USDMYR is trading at 4.0920.

Hong Leong Bank

## *MYR government bond auctions saw strong demand in Feb for 10Y and 15Y govvies*

MGS/GII issuance pipeline in 2019

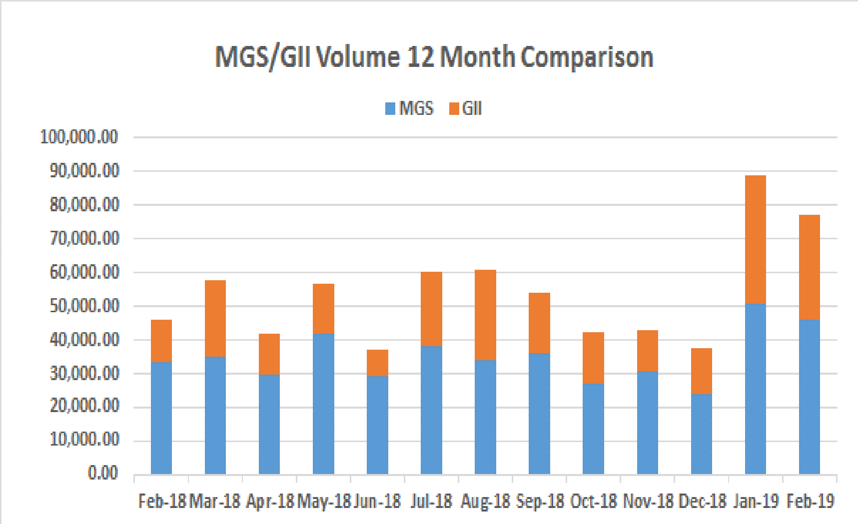
| No | Stock | Tenure (yrs) | Tender Month | Quarter | Tender Date | Projected Issuance Size (RM mil) | Actual Auction Issuance (RM mil) | Private Placement | Amt Issued YTD | BTC (times) | Low | Average | High | Cut-off |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 10.5-yr New 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 | | 4,000 | | | | | | | | |
| 8 | 30-yr Reopening of MGS (Mat on 07/48) | 30 | Mar | Q1 | | 3,500 | | | | | | | | |
| 9 | 7-yr New Issue of GII (Mat on 03/26) | 7 | Mar | Q1 | | 4,000 | | | | | | | | |
| 10 | 15-yr Reopening of MGS (Mat on 11/33) | 15 | Apr | Q2 | | 4,000 | | | | | | | | |
| 11 | 5.5-yr New Issue of GII (Mat on 10/24) | 5 | Apr | Q2 | | 4,000 | | | | | | | | |
| 12 | 7-yr Reopening of MGS (Mat on 07/26) | 7 | Apr | Q2 | | 4,000 | | | | | | | | |
| 13 | 30.5-yr New Issue of GII (Mat on 11/49) | 30 | May | Q2 | | 4,000 | | | | | | | | |
| 14 | 10-yr Reopening of MGS (Mat on 08/29) | 10 | May | Q2 | | 4,000 | | | | | | | | |
| 15 | 15.5-yr New Issue of GII (Mat on 11/34) | 15 | May | Q2 | | 4,000 | | | | | | | | |
| 16 | 5-yr New Issue of MGS (Mat on 06/34) | 5 | Jun | Q2 | | 4,000 | | | | | | | | |
| 17 | 20-yr Reopening of GII (Mat on 09/39) | 20 | Jun | Q2 | | 3,500 | | | | | | | | |
| 18 | 15-yr New Issue of MGS (Mat on 07/34) | 15 | Jul | Q3 | | 4,000 | | | | | | | | |
| 19 | 7-yr Reopening of GII (Mat on 3/26) | 7 | Jul | Q3 | | 4,000 | | | | | | | | |
| 20 | 30-yr Reopening of MGS (Mat on 07/48) | 30 | Jul | Q3 | | 3,000 | | | | | | | | |
| 21 | 5-yr Reopening of GII (Mat on 10/24) | 5 | Aug | Q3 | | 4,000 | | | | | | | | |
| 22 | 20-yr Reopening of MGS (Mat on 06/38) | 20 | Aug | Q3 | | 3,500 | | | | | | | | |
| 23 | 10-yr Reopening of GII (Mat on 7/29) | 10 | Aug | Q3 | | 3,500 | | | | | | | | |
| 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 | | 3,500 | | | | | | | | |
| 27 | 20-yr Reopening of GII (Mat on 09/39) | 20 | Oct | Q4 | | 3,000 | | | | | | | | |
| 28 | 5-yr Reopening of MGS (Mat on 06/24) | 5 | Oct | Q4 | | 4,000 | | | | | | | | |
| 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 | | 3,500 | | | | | | | | |
| 32 | 15-yr Reopening of MGS (Mat on 07/34) | 15 | Dec | Q4 | | 3,500 | | | | | | | | |
| | Gross MGS/GII supply in 2018 | | | | | 119,000 | 20,000 | 4,000 | | | | | | |

*Source: BNM, HLB Research*

The two (2) government bond tenders concluded for the month of Feb 2019 under the auction calendar included the reopening of the much-awaited 10Y MGS 8/29 (BTC ratio of 2.54x averaging 3.885%) and longer-tenured 15Y GII 6/33 (BTC ratio of 3.91x averaging 4.37%). The latest auction for the 3Y MGS 3/22 reopening on 7th of March similarly saw inter-bank players bid-up for the papers at a BTC ratio of 3.13x. Overall weighted average BTC for the month improved to an impressive 2.99x. (Compare this with both the entire 33 auctions for 2018 which notched a BTC ratio of 2.29x). Tenders for the month received a surge in interest due to strong support by both foreign and local institutional investors.

### *Trading volume for MGS/GII pull-backed slightly in February…*

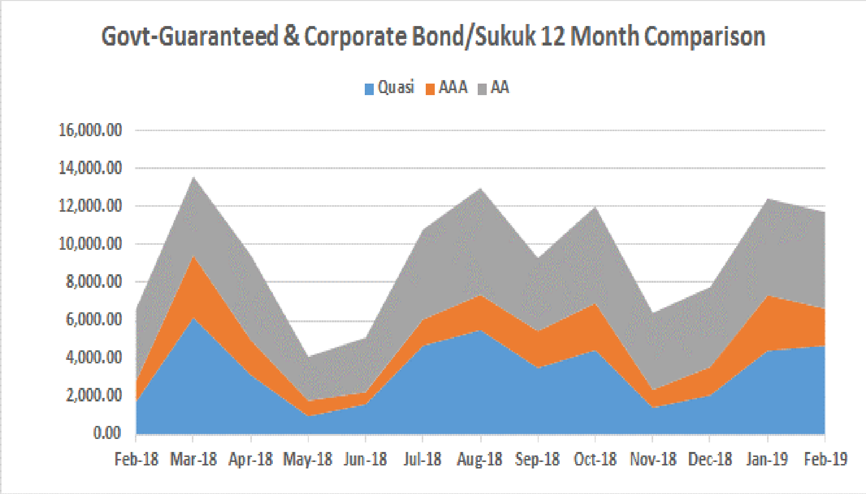
Trading volume for MYR govvies eased to RM77.7b in February compared to previous month's RM89.2b. Traction was nevertheless maintained across the curve with substantial frequency of trades and nominal amounts done in the short off-the-run 19's (ended mixed between -3 to +3bps) and 28's (ended largely lower between 8-9bps). Both MGS and GII 5Y, 7Y and 10Y benchmarks (ended between 3-6bps lower) also saw active trades. The 28's which were incidentally the previous 10Y benchmarks formed almost 12% of total volume for the month under review. Off-shore investors turned net buyers instead for MYR govvies in February on risk-on sentiments and a result of demand for EM assets. The month under review saw Malaysian bonds generally maintain its December-January rally on the back of both foreign and local investors.




*Source : BPAM, Bloomberg, HLB Research*

### *Corporate bonds/Sukuk maintained robust secondary trades…*

In the secondary market, Corporate bonds/Sukuk (including Govt-Guaranteed bonds) saw an expected pull-back in secondary market trading volume i.e. from RM13.9b in January to RM11.0b in February due to the short month along with the Chinese Lunar Holidays. The solid interest saw fund managers/portfolio investors participate actively in the secondary market on yield-enhancement requirements coupled with improved liquidity conditions for credits (we included Govt-guaranteed bonds i.e. GG papers together for ease of reference). The rate pause outlook in the US by the Fed and market generally spurred a risk-on demand for EM assets. Investor appetite for GG, and AA-rated bonds maintained traction MOM with the AA-rated bonds formed some 43% of the February's transactions as investors maintained the hunt for wider yield spreads over MYR Govvies. Unlike the previous month, a fresh supply of GG bond issuances was lauded. The short AAA-rated CAGAMAS 7/19 and the Govt guaranteed GOVCO 2/24 topped the monthly volume; closing 1bps and 15bps lower respectively at 3.71% and 4.05% for the month respectively compared to previous-done levels. This was followed by another CAGAMAS 8/19 bond and AA2-rated BENIH RESTU 6/25 which also rallied by 13-25bps to close at 3.68% and 4.53% respectively. Appetite in the credit space was mainly seen in a wide range of bonds namely infrastructure-related bonds including energy, toll and telecommunication sub-sectors of the economy including AA-rated BGSM 19-26, Sarawak Energy Bhd 22-31, EDRA Energy 23-37, KESTURI 25-28 and also AAA-rated TENAGA 21-38 and TELEKOM 23-28. Conglomerate DRB-Hicom 2022 papers, Genting-related bonds and Khazanah's funding conduit i.e. DANGA 2020-2023 bonds were also heavily traded. In the banking space a higher frequency of trades were noticed for both Affin Bank and Alliance Bank papers. (We have excluded single-A rated and non-rated papers in the illustration below).



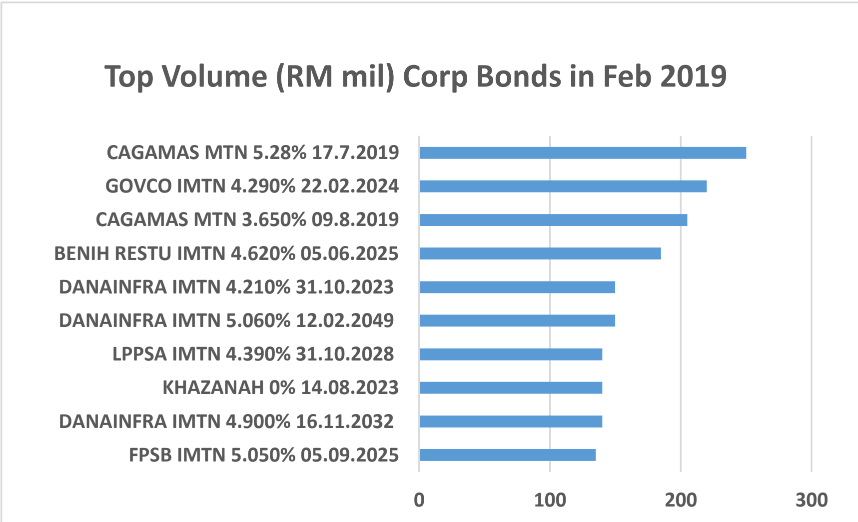

*Source : BPAM, Bloomberg, HLB Research*

### *Primary issuance print in February boosted by following names:*

| Notable issuances in Feb-19 | Rating | Amount Issued (RM mil) |
|---|---|---|
| DanaInfra Nasional Berhad | GG | 3,000 |
| Danum Capital Berhad | AAA | 1,500 |
| DRB-Hicom Berhad | A1 | 265 |
| Hap Seng Management Sdn Berhad | NR | 165 |
| Hunza Properties (Penang) Sdn Berhad | NR | 370 |
| Pengurusan Air SPV Berhad | GG | 1,000 |
| Pengurusan Air SPV Berhad | AAA | 2,500 |
| Paramount Capital Resources Sdn Berhad | NR | 121 |
| Pasukhas Green Assets Sdn Berhad | NR | 17 |
| Sunway Treasury Sukuk Sdn Berhad | NR | 200 |
| | | 9,138 |

*Source : BPAM, Bloomberg, HLB Research*

Total fresh issuances of all ratings of Corp Bonds/Sukuk improved to ~RM9.1b (January: RM5.9b only) with GG issuances making a come-back; forming some 45% of total issuances. The largest issuance involved national rail transporter i.e. Danainfra Nasional Berhad with a massive RM3.0b issuance consisting of 7-30Y bonds.




*Source : Bloomberg, BPAM, HLB Research*

## *Outlook for March*

### *Investors may continue to be net-buyers of MYR bonds amid government's tough fiscal decisions & global trade headwinds….*

The weighted average BTC for the two (2) auctions February averaging 2.99x is strong testimony to the depth of the local govvies market compared to the average BTC of 2.29x for 2018. At the time of writing another reopening of RM3.5b 3Y MGS 3/22 similarly saw solid demand on a BTC ratio of 3.13x; averaging 3.47%. We believe valuations still exist in selective parts of the curve as we are now of the view that **BNM may cut OPR** due to the "materialization of downside risks" as opposed to previous MPC's statement stating that "the external sector is likely to soften with moderating global growth. The Ringgit is seen to stabilize at current 4.0700-1000 levels following BNM's "dovish-like" tone and extremely mild inflationary conditions.

The successful issuance of RM7.4billion yen-denominated issuance in March at a revised lower coupon of ~0.55% is expected to augur well for the nation in terms of replacement funding. Moody's Investor Service in its periodic review has reaffirmed the nation's A3 credit profile; supported by its high economic and institutional strength. However its fiscal strength remains moderate considering its relatively high debt burden and narrow revenue base that is reliant on oil and non-tax revenues. The risk-on mode have allowed inflows into EM's and subsequently into Malaysia; resulting from the shift in US rate hike outlook. The recent stark rise in foreign holdings for Malaysian debt securities last month has completely reversed prior two (2) consecutive months (Dec 2018-Jan 2019) and is a good indicator of what to expect in the coming months. Investors may however have some concerns surrounding the unresolved US-China trade deadlock which may dampen the risk appetite for financial assets.

We expect a robust March intertwined with profit-taking as participation is expected to be led by both foreign and local institutions due to possibility of a potential rate cut, decent comparative yields and improving liquidity conditions. Net maturities for MYR govvies in March is however sizeable; at RM7.2b. **Overall values are not compelling at this juncture but investors are expected to watch both the 7-9Y and 15Y space whilst taking cognizance of the rather rich valuations for the 10Y. Demand for Ringgit Corporate Bonds/Sukuk along the GG segment will continue to be strong despite the easing supply concerns and provides for a better yield pick-up compared to MGS/GII and semi-quasi papers issued by i.e. Cagamas/ Khazanah. Likewise the AA-rated space i.e. infrastructure and energy-related related bonds may continue to provide both yield-enhancement and liquidity** whilst mild concerns on the sustainability of credit metrics by bank-backed issuances may be ignored due to well-capitalized nature of Malaysian banks.

### *Fed dot plot continues to indicate a pause in Fed rate hike…*

The movement of UST yields in February saw the curve move higher whilst adopting a slight steepening-bias instead. The UST 10Y saw the smallest trading range of ~12bps ever since February 2006 despite stronger than expected US GDP 4Q growth of 2.6%; possibly helped by muted core inflation as rates volatilities tank. Latest revisions for interest rate outlook in 2019 reveal Fed Dot Plot hike of up to two (2) rate hikes whilst the Fed Fund Futures is now pricing in no interest rate hike at all ~ similar to investor expectations; thus allowing UST's to find strong support at the moment. The Federal Reserve's decision to allow interest rates to stay on hold for now is due to muted inflation while the Fed Chair Powell said he and his colleagues will be looking at growth, job creation, wages and inflation as it thinks about its next steps, and will keep an eye on China, Europe and events including Britain's ongoing exit negotiations with the EU. Interestingly the better recession predictor i.e. the 2s10s spread at the time of writing remains unchanged circa 15bps this month. The likelihood of resolving the global trade issue marathon is high and risk assets may slowly be in vogue during March-April period.

**We expect data to surprise on the upside in the US and potentially causing the curve to steepen as the rate-sensitive front-end may be seen as a pivot for now.** Rates could gradually inch back up in March-April on the back of sustained expansion of economic activity, strong labor market conditions, and muted inflation over short-to-medium term. **Short-to-intermediate duration portfolios (~2-5 years) may still be favorable as shorter UST's now offer much yield comparable to the 10Y but on lesser duration risk**. **State and local municipal-debt is favored due to strong demand and lighter supply metrics.** However, risks to the above assumptions remain if US-China global trade tariff barriers become unresolved.

**In the Credit/Corporate space, investors are still expected to favor Investment Grade issuances which are deemed to be undergo less stress at ~180-200bps spreads** instead of High Yield names, as these corporates are better-equipped to weather funding constrains amid the test of global trade uncertainties. However, market conditions are favoring US companies issuing IG Euro-denominated bonds due to lower costs, yields and weakness in Euro for now to the detriment of yield-hungry investors

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