Global Markets Research

Fixed Income

Monthly Perspective – Feb 2019

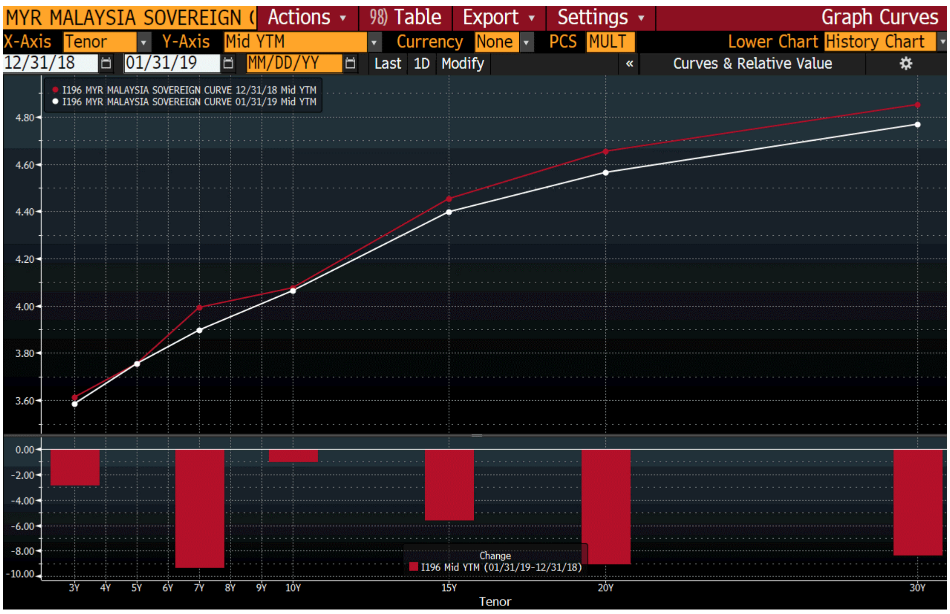
MYR Bond Market

Recapping the month of January

The US saw a massive rise in payrolls for January with US Treasuries (UST's) curve shifting lower as price gains were seen across most tenures; somewhat similar to equity moves. Most tenors saw a rally with yields lower between 2-7bps with the belly seeing most gains up to the 10Y tenure following safe-haven bids amid global growth concerns and looser financial conditions since the January FOMC meeting. The front-end rates i.e. 2Y UST yields fell by 3bps to 2.46% 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 2.55% and a high of 2.78% levels before rallying 6bps lower MOM at 2.63% levels. The dollar had generally ended mixed-to-weaker against the G10 currencies whilst strengthening between 1.2-2.2% against only the Swiss Franc and Swedish Krona in January as the Dollar Index pulled back to 95.5 levels. The US yield curve saw slight steepening bias extending out, as the 2s10s spread narrowed from 19 to 17bps whilst the 5s30s spread widened by 5bps to 55bps.

*On the local front, **MYR bonds** surprisingly saw a continued decline in foreign holdings in January compared to prior month's decrease amid a robust and enormous secondary trade volume of RM103.1b (Dec:RM46.3b). The foreign holdings decreased by RM2.4b MOM to RM182.5b, almost similar to December's outflow. The percentage of foreign holdings of MYR government bonds fell to 22.2% or RM161.0b of total outstanding MYR Govvies consisting of MGS+GII+SPK. (Dec: RM162.5b or 22.7%). Overall benchmark MGS/GII bonds ended lower with most tenures lower between 1-9bps. The 5Y MGS 4/23 was unchanged at 3.76% whilst the much-watched 10Y MGS 6/28 whose volume more than doubled saw yields edge 1bps lower at 4.06% levels. (At the time of writing however the 10Y has rallied to break the 4.00% barrier for the first time since April 2018). Corporate Bonds/Sukuk saw a marginal drop of RM204m in the levels of foreign holdings at RM13.8b. Local institutional investors were still net buyers on rising interest; causing yields to end lower.*

MYR sovereign curve (MGS)



Source : Bloomberg

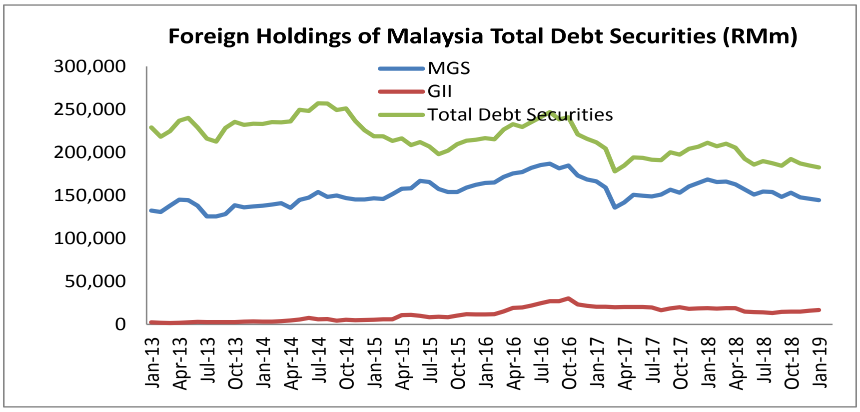
Solid NFP in January; despite weaker wage gains as unemployment rate rose marginally to 4.0%….

January Non-Farm Payrolls ("NFP") surprised by the printing of 304k compared to market consensus of 222k (Dec: revised downwards from 312k to 222k) pointing to robust labor market whilst the unemployment rate crept up from 3.7% to 4.0% mainly due to the partial government shutdown. Participation rate edged up to a 5-year high of 63.2% which denotes confidence in job prospects. Wages however disappointed; slowing in the month to 0.1% MOM (previous: 0.3%), a cooler gain than the prior month and expectations. That backs the Fed's more patient approach with interest rates at least for the initial part of 2019. 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. The current Fed's dot plot is meant to reassure that the economy is on a sound footing and support the case for two (2) interest rate increases for 2019 with the next policy-meet on 20th March following the four (4) Fed hikes to 2.25-2.50%.

To recap, the US central bank said in its January 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 and that economic activity has still maintained its momentum. After revisions, the average pace of employment growth in 2018 was 223k -- the fastest pace since 2015, signaling that labor-market conditions remain robust. If job gains continue at even three-quarters of the January pace, the Fed will likely have to walk back some of its recent dovish commentary. However, its preferred inflation measure for January i.e. the core CPI was little changed i.e. rising 0.2% MOM (Dec: 0.2%) and 2.2% YOY (Dec: 2.2%). The sanguine fuel prices contributed to the muted impact on inflation towards the economy the past month. However, the 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) may reignite inflationary pressures and cause rates to rise faster than expected. The mitigating factors that may derail the rate hike path is the potential fallout arising from escalating US-China trade; slowing global growth which will provide safe-haven bids for UST's.

Foreign Holdings of overall MYR bonds eased again in January despite stronger momentum and demand for EM assets…

Foreign holdings of MYR bonds saw the 3rd successive month of decline with January's total holdings lower by RM2.4b or 1.3% to RM182.5b. The non-resident holdings of MGS was substantially lower by RM1.7b to RM144.4b; representing 37.6% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw smaller decline of RM1.1b or 0.7% to RM161.0b due to the slight increase in GII bond holdings. This represented 22.2% of total outstanding; the lowest level of foreign holdings on more than two (2) straight years.



Source: BNM, HLB Research

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

BNM maintained the OPR at 3.25% at the first MPC meeting of the year on 24th of January amid subdued inflation and slightly weaker economic growth outlook for 2019 (Note: that the last hike was 25bps in January last year). The central bank reiterated that at the current interest rate level; the degree of monetary accommodativeness is consistent with the intended policy stance. There appears to be further room for cutting rates (if need be) amid low inflation of below 1.0% for the past six (6) months due to the adjustment and floating of the fuel pricing mechanism. Nevertheless, 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 demand for EM assets, foreign portfolio outflows in January were met with strong local institutional demand. (Note: Net MYR outflows for last year i.e. 2018 year were RM21.9b for bonds and RM10.7b for equities). On the currency side, the USDMYR continued to see MYR strengthen ~1.0% at 4.0953 levels as at end-January (at the time of writing is 4.0653) but mixed against most Asian currencies

MYR government bond auctions saw solid demand in Jan for 10Y and 7Y govvies

MGS/GII issuance pipeline in 2019

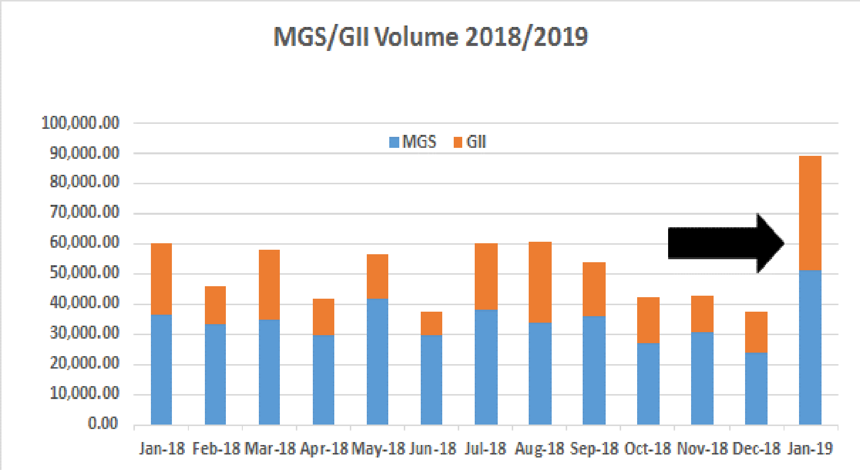
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Projected Issuance Size (RM mil)	Actual Auction Issuance (RM mil)	Private Placement	Amt Issued YTD	BTC (times)	Low	Average	High	Cut-off
1	10.5-yr New Issue of GII (Mat on 07/29)	10	Jan	Q1	8/1/2019	4,000	3,500	1,500	3,500	4.067	4.110	4.130	4.135	86.1%
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		4,000								
5	15-yr Reopening of GII (Mat on 06/33)	15	Feb	Q1		3,000								
6	3-yr Reopening of MGS (Mat on 03/22)	3	Mar	Q1		3,500								
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	11,000	2,000						

Source: BNM, HLB Research

The three (3) government bond tenders concluded for the month of Jan 2019 under the auction calendar included the reopening of the much-awaited 10Y GII 7/29 and mid-tenured 7Y MGS 7/26 which together saw a massive BTC ratios of 4.07x (averaging 4.13%) and 2.22x (averaging 3.906%). Overall average BTC for the month was impressive 2.72x. (Compare this with both the previous Dec month average and also the entire of 2018 consisting of 33 issuances in total which notched a BTC ratio of 2.29x). Tenders for the month received strong support mainly by local followed by foreign institutional investors amid a surge in interest.

Trading volume for MGS/GII spiked in January…

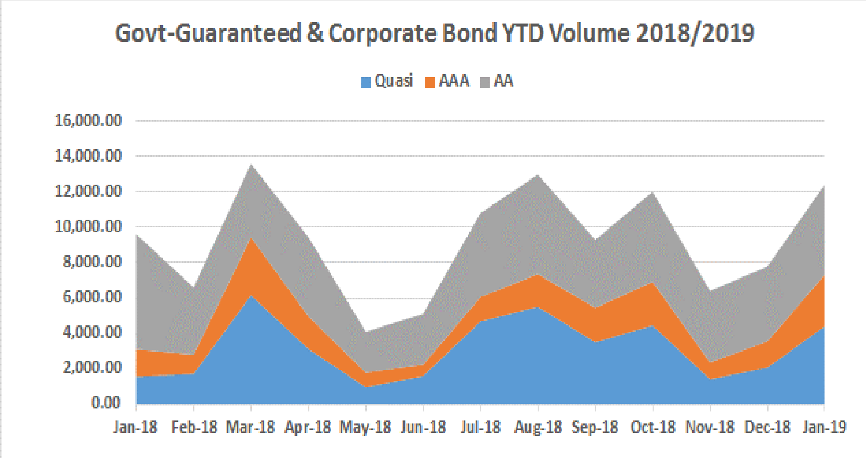
Trading volume for MYR govvies ballooned to RM89.2b in January compared to last December's RM37.6b. Traction was seen across the curve with substantial frequency of trades and nominal amounts done in the short to mid-tenured off-the-run 19-20's (ended mixed between -5 to +1bps), 23-25's (ended 0-8bps lower), and also both MGS and GII benchmarks 10y and 15Y bonds (ended mixed between 1-13bps lower~ as per our earlier observation and recommendation). The latter two formed almost 25% of total volume for the month under review. Off-shore investors continued to turn net sellers for MYR govvies in January despite risk-on sentiments including demand for EM assets. The month under review saw Malaysian bonds continue its December rally on the back of mainly local institutional support.



Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk interest activity turned robust…

In the secondary market, Corporate bonds/Sukuk (including Govt-Guaranteed bonds) saw a huge rise in secondary market trading volume i.e. from RM8.7b in October to RM13.9b in January. Yield enhancement requirements by fund managers/portfolio investors on rising interest and liquidity improved conditions for this asset class involving credits. The potential pull-back on US rate hike expectations by the Fed and market generally motivated demand for EM assets. Investor appetite for all three (3) i.e. GG, AAA and AA-rated bonds improved MOM; with both Govt-Guaranteed bonds (GG) and AAA-rated bonds DOUBLING in volume. Overall, the AA-rated bonds formed some 41% of the January transactions as investors maintained the hunt for wider yield spreads over MYR Govvies. There was a dearth of GG bond issuances compared to prior month's RM2.0b PRASA issuance as investor demand was not fully met following the reduction in such issuances post GE14 in May due to government's overall assessment of its contingent liabilities arising from major infrastructure projects. Affin Islamic T2 28NC23 and the short A1-rated bond TF Varlik 6/19 topped the monthly volume; closing a whopping 8bps and 20bps lower respectively for the month compared to previous-done levels. This was followed by both AA1-rated YTL Power 8/28 and 5/27 which also rallied by 3-4bps to close at 4.91% and 4.83% respectively. Appetite in the credit space was also seen in infrastructure-related bonds including energy and telecommunication sub-sectors of the economy i.e. AA-rated BGSM 19-25, MALAKOFF 19-30, Sarawak Energy Bhd 19-29, EDRA Energy 23-38, KESTURI 23-33, CELCOM 19-26 and also AAA-rated TENAGA 21-28 and TELEKOM 22-24. (We have excluded single-A rated and non-rated papers in the illustration below).



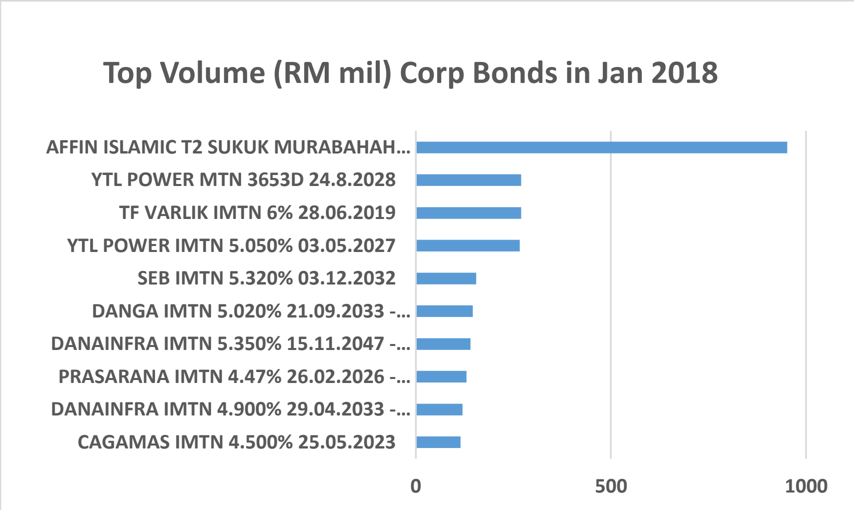
Source : BPAM, Bloomberg, HLB Research

Primary issuance print in January boosted by following names:

Notable issuances in Jan-19	Rating	Amount Issued (RM mil)
Alam Maritim Resources Berhad	D	81
Axis REIT Sukuk Berhad	NR	240
Boustead Holdings Berhad	NR	200
Kuantan Port Consortium Sdn Berhad	NR	30
Exsim Capital Resources Berhad	AA3	290
Malayan Banking Berhad	AA1	3,700
Cagamas Berhad	AAA	95
Damansara Uptown Retail Centre Sdn Berhad	NR	25
Glenealy Plantations Sdn Berhad	NR	50
KDU University College (PG) Sdn Berhad	NR	15
KL East Sdn Berhad	NR	358
OCR Land Holdings Sdn Berhad	NR	15
Perbadanan Kemajuan Negeri Selangor	AA3	180
Sabah Development Bank Berhad	AA1	65
Southkey Megamall Sdn Berhad	NR	50
Tiger Synergy Berhad	NR	13
Sports Toto Malaysia Sdn Berhad	AA3	25
Perangsang Capital Sdn Berhad	NR	300
OSK I CM Sdn Berhad	NR	200
OSK I CM Sdn Berhad	NR	300
		5,930

Source : BPAM, Bloomberg, HLB Research

Total fresh issuances of all ratings of Corp Bonds/Sukuk were maintained at~ RM6.0b in January; however with the absence of GG bonds. The largest issuance emanated from Maybank Bhd with a massive RM3.7b issuance consisting of 10NC5 and 12NC5 bonds.



Source : Bloomberg, BPAM, HLB Research

Outlook for February

Headwinds from tough local fiscal policies pushed aside as investor demand expected to continue on potential EM inflows….

The average BTC for the three (3) auctions in January averaging 2.72x is strong testimony to the depth of the local govvies market compared to the average BTC of 2.29x for 2018 and 2.20x for 2017. At the time of writing the new issuance of RM4.0b 10Y MGS 8/29 saw solid demand on a BTC ratio of 2.54x; averaging 3.867%. We believe that valuations are emerging in selective parts of the curve as we continue to maintain our view BNM will keep the OPR unchanged due to mild inflationary outlook i.e. replacement of GST with SST and the reintroduction of the floating mechanism and subsidy for RON 95 petrol and diesel.

The Ringgit is seen to strengthen and stabilize at current 4.06-08 levels following the better 4Q GDP of 4.7% YOY (3Q:4.4%) and 4.7% YOY for the full year of 2018 amid better than expected export numbers. The net federal deficit at RM53.2b or 3.7% of GDP is expected to be absorbed via issuance of local govvies and the assistance of Petronas's RM30.0 one-off dividend payment. The upcoming RM7.4billion yen-denominated issuance in March at a low coupon of ~0.65% is expected to augur well for the nation in terms of replacement funding. The deferment or downsizing of infra projects like the gas-pipeline project, ECRL, HSR, MRT3, Pan-Borneo highway together with the plugging of pilferage and excessive expenditures by government agencies are lauded and expected to gradually attract portfolio inflows. The inflows into EM's are obvious beginning January; thanks to the shift in US rate hike outlook. The recent continued reduction in foreign holdings for Malaysian debt securities for three (3) consecutive months (Nov 2018-Jan 2019) is believed to be temporary. Investors concern surround the US-China trade deadlock which may dampen appetite and encourage fight-to-safety for UST's. Net maturities for MYR govvies in February and also March is minimal circa RM500m and RM7.2b respectively.

We expect a robust February laced with intermittent profit-taking with participation led by local institutions followed suit by foreign investors' interest due to yield-carry requirements and better liquidity conditions. **Overall values may not be compelling at this juncture but investors are expected to watch both the 7Y and 15Y space instead as the 10Y indicated rich valuations. Demand for Ringgit Corporate**

Bonds/Sukuk along the GG segment is strong due to supply concerns and provides for a yield pick-up compared to sovereign and other quasi-government papers issued by i.e. Cagamas and Khazanah. Likewise the AA-rated space i.e. banking and energy-related related bonds may continue to attract attention due to yield and liquidity reasons.

Fed dot plot indicates a pause in Fed rate hike for now…

The movement of US Treasury yields in January saw the curve adopt a slight steepening-bias instead and 2-7bps move lower. Latest revisions for interest rate outlook in 2019 reveal Fed Dot Plot reduction of up to only two (2) rate hikes whilst the Fed Fund Futures is pricing in up to one (1) rate hike; as opposed to investor expectations of no interest rate hikes at all; allowing UST's to find relief at the moment. The Federal Reserve's decision in January to scrap a promise for further rates hikes and be "patient" on further moves took financial markets and economists by surprise with signs of widening spreads in the credit markets signaling tighter financial conditions. However the better recession predictor i.e. the 2s10s spread at the time of writing remains unchanged circa 15bps this month. Ultimately, the likelihood of resolving the global trade checkmate is higher and risk assets are slowly back in favor for January-March period. The continued swelling of debt issuance by the U.S. Treasury Department is worth noting as well. **We expect some positive data to emerge and surprise; potentially causing the curve to bear steepen as the front-end is seen anchored for now.** Rates could gradually move back 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 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.** The downside risks to the above assumptions are the negative impact on US-China global trade issues, and the potential paring down of foreign holdings by giants China and Japan. **In the Credit/Corporate space, investors are still 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 funding constrains amid the test of global trade uncertainties.

Hong Leong Bank Berhad
Fixed Income & Economic Research, Global Markets
Level 8, Hong Leong Tower
6, Jalan Damanlela
Bukit Damansara
50490 Kuala Lumpur
Tel: 603-2081 1221
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my