Monthly Perspective – July 2019

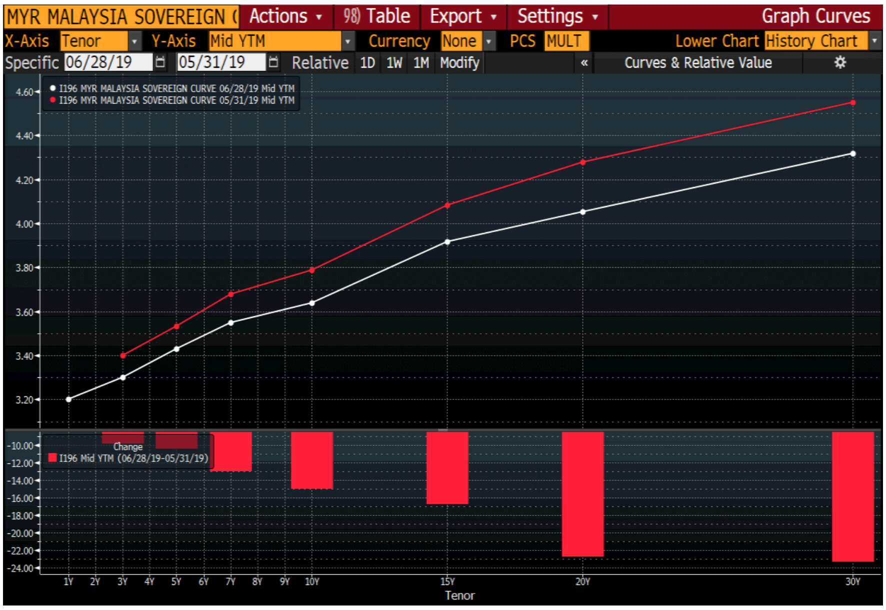
MYR Bond Market

Recapping the month of June

US Treasuries (UST's) *rallied on safe-haven bids; a global phenomenon seen in sovereign bonds amid unresolved global trade issues and anticipated dampening in economic outlook. Benchmark* ***UST yields continued to end lower between 12-28bps.*** *The UST yield curve saw an almost parallel shift lower with the front-end inversion intact for almost a month as both the 3m10s and the 2s10s spread maintained ~about -8bps and 24bps respectively. The solid US payrolls for June coupled with tepid inflation outlook (which remained below policy-makers' 2.0% target) boosted demand for UST's. The front-end UST 2Y yield moved 16bps lower MOM at 1.76% levels whilst the 10Y, which depicts as a benchmark for US mortgage rates and inflation indicator, saw lesser volatility in June; ranging between a low of 1.97% and a high of 2.15% levels and settled 12bps lower MOM at 2.01%. The US Dollar meanwhile ended weaker against all G10 currencies, even as the Dollar Index has recovered to 97.4 levels at the time of writing compared to 96.13 as at end-June.*

On the local front, ***MYR bonds*** *saw foreign holdings rebound in June as secondary market volume picked up slightly to RM81.6b (May: RM80.8b) due to pent-up demand arising from safe-haven bids mainly by onshore real money as global growth concerns remain unresolved. Foreign holdings of total Malaysian govvies spiked by RM6.6b MOM to RM182.6b; reversing nearly half of April and May's combined outflows of RM14.0b. The percentage of foreign holdings of MYR government bonds (MGS + GII + SPK) rose to 21.5% or RM163.8b of total outstanding issuance. (May: RM158.0b or 21.8%).* ***Overall benchmark MGS/GII bonds rallied further with yields down between 10-23bps.*** *The 5Y MGS 4/23 moved 10bps lower at 3.42% whilst the much-watched 10Y MGS 8/29 ended 15bps lower from 3.78% to 3.63% levels. Corporate Bonds/Sukuk however saw levels of foreign holdings maintain at ~RM12.0b. Many institutional investors comprising pension funds and insurance companies were net buyers causing yields to grind lower on sustained volume of RM14.3b in June.*

MYR sovereign curve (MGS)



Source : Bloomberg

Solid NFP data for June and muted inflation are impediments to rate cuts…

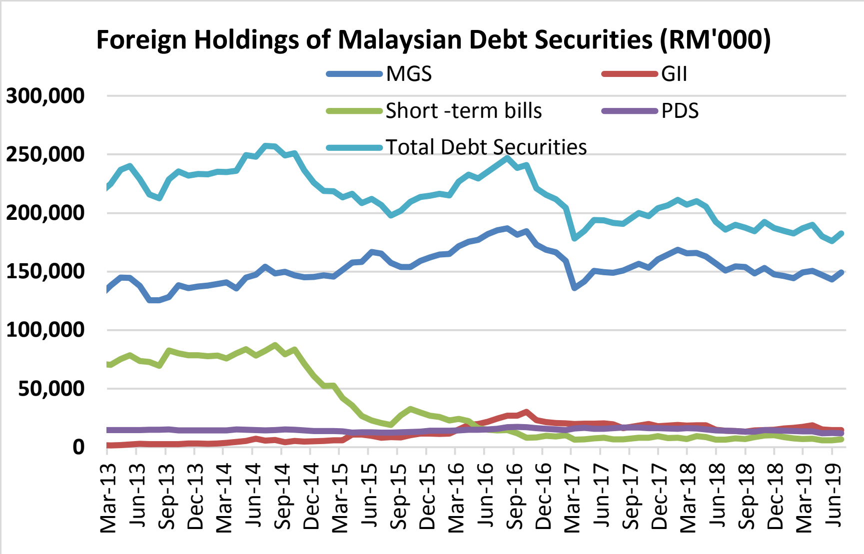
June Non-Farm Payrolls ("NFP") powered on the upside with the printing of 224k new jobs; exceeding market consensus of 160k (May: revised slightly lower from 75k to 72k) and pointing to a strong labor market. This snapped the prior month's weak hiring but nevertheless the market odds for a **July rate cut of 25bps is between 96-99%** according to both Bloomberg survey and CME Fed Watch Group. This has affirmed that the economy is still on sound footing considering the weakness in other global economies. The unemployment rate however inched up from 3.6% to 3.7% and believed to be largely attributable to the decent participation rate of 62.9% which was also slightly higher by 0.1ppt for the month. However the continued decent print on hourly wages i.e. +0.2% MOM (previous: +0.3%) and +3.1% YOY (previous: +3.1%) was a key indicator showing that the 11^{th} straight month of YOY gains at/or above the 3.0% threshold conflicts the lower interest rate outlook.

The US central bank left rates unchanged at 2.25-2.50% as widely expected in its June FOMC statement. While the Fed dropped its "patient" language from its policy guidance at its June meeting, the strength in the pace of hiring will enable the FOMC to re-think the onset of an easing cycle. However it is believed that the Fed will still need to cut in July in order to steepen the yield curve. Despite the current **Fed's dot plot reflecting a status-quo stance** on interest rate outlook for 2019; more Fed members have begun to strike a downshift tone (compare that with the Fed's projection of two rate hikes in late-2018). The Fed's minutes for the June meeting offered more clues of a near-term possibility of a rate cut as multiple policymakers said rates should come down to "cushion the effects" of a U.S. trade war and to firm up inflation that is failing to meet the central bank's 2%-a-year target. However market observers note that Powell is aware of the Fed's "baseline outlook" of slower U.S. growth against a considerable set of risks - including persistently weak inflation, slower growth in other major economies, and a downturn in business investment driven by uncertainty over just how long the Trump administration's trade war with China and other countries will last and how intense it will become. The Fed's preferred inflation measure for June i.e. the personal consumption expenditure (PCE) price index was lower at 1.5% YOY whilst the core index (which strips out the volatile food and energy costs) was maintained at 1.6%. Meanwhile, the balance sheet tapering/roll-off is still scheduled to end in September by another $35b per month in May through September (an additional $175b); allowing it to scale back from ~$3.83trillion currently to a targeted level of $3.7trillion by Sep-2019.

Foreign holdings of overall MYR bonds spiked in June on strong local participation…

Foreign holdings of MYR bonds rebounded by RM6.6b or 3.8% MOM in June following back-to-back falls in April and May. The non-resident holdings of MGS increased by RM5.8b to RM149.1b in June (representing 36.9% of total outstanding) whereas total MYR Government bonds (i.e. MGS+GII+SPK) holdings similarly saw a rise of RM5.8b to RM163.8b (representing 21.5% of total outstanding) amid net issuances of RM8.0b for the month (May: RM12.0b).

The recent report in May on the US Treasury Department's Semi-Annual Currency report that placed Malaysia on the US Treasury's Monitoring List followed by news in April on the Norwegian Sovereign Fund and FTSE Russell index's intention to underweight MYR bonds seems to be on the back-burner for now as foreigner increased their holdings. YTD overall, both MYR bonds and equities saw a net decrease in foreign holdings of a mere RM2.2b and RM4.7 respectively in the first six (6) months of 2019. On the currency side, the MYR strengthened by 1.6% at 4.1240 levels as at end-June and also against many Asian currencies save for the Korean Won and Thai Baht. However at the time of writing, USDMYR is trading at 4.1240 amid weakness in the USD.



Source: BNM, HLB Research

MPC stays pat on OPR but takes cognizance of downsize risks and monitors risks to domestic growth and inflation….

BNM maintained the OPR at 3.00% at the 4th MPC meeting of the year recently on the 9th of July, stating monetary policy remains accommodative while it continues to monitor risks to domestic growth and inflation. (Note: The last policy move was a 25bps cut in May 2019). Expect 2Q2019 GDP growth to be continue hover at the mid-4% levels as a pick-up in industrial production is expected to be mitigated by net export drag (1Q2019: 4.5%). Given rising external challenges, we foresee downside risks to our full year GDP growth of 4.7% going forward. We opine that the stable and muted headline and core inflation data of 0.2% and 0.5% YOY respectively will provide the central bank more flexibility in its policy decision; helped to a certain extent by the price ceiling on domestic fuel prices. (Note: No revision has been forthcoming to-date despite expiry of the June deadline). The current low level of rates has allowed MYR bonds to rally; thus allowing existing portfolio investors to reap gains but also diminish the current yield appeal of MYR bonds by new investors. The government is monitoring US tariff threats to global demand to assess the need for adjustment in the degree of monetary accommodativeness. While the tone is neutral hinting at no move in the near term, the central bank is closely monitoring potential fallout from prolonged trade tension, suggesting that another rate cut cannot be totally discounted.

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

The two (2) government bond tenders concluded for the month of June 2019 under the auction calendar included the new issuances for the 5Y MGS 6/24 and reopening of 20Y GII 9/39. Overall weighted average BTC for the month **strengthened to 3.08x** mainly due the stronger GII auction. This obviously stood out when compared to both the YTD BTC of 2.68x and also the entire 33 auctions for 2018 which notched a BTC ratio of 2.29x). Tenders for the month received decent bids from mainly large local institutional investors. The subsequent auction at the time of writing in July include the new issuance of 15Y MGS 7/34 that saw massive RM12.0b worth of bids resulting also in an impressive BTC ratio of 3.44x.

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		3,000								
20	30-yr Reopening of MGS (Mat on 07/48)	30	Jul	Q3		2,500								
21	5-yr Reopening of GII (Mat on 10/24)	5	Aug	Q3		3,500								
22	20-yr Reopening of MGS (Mat on 06/38)	20	Aug	Q3		3,000								
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		3,000								
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		15,000						

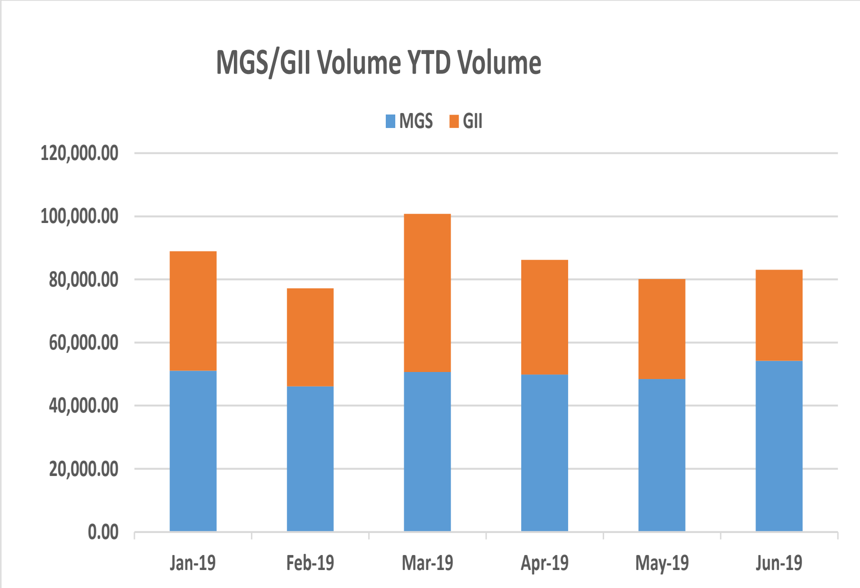
Source: BNM, HLB Research

Trading volume for MGS/GII remained steadfast in June…

Trading volume for MYR govvies picked up slightly to RM81.6b in June compared to prior month's RM80.1b. Interest was seen across the curve especially on the longer ends late in the month with substantial frequency of trades and nominal amounts done in the off-the-run 19-20's, 23-25's, 10Y (both current and previous benchmarks forming ~12% of total trades) and also 15Y (both current and previous benchmarks forming ~6% of total trades) MGS/GII bonds. The current 30Y MGS 7/48 benchmark also saw decent volume; as investors long duration. Yields ended richer by 10-23bps across the curve The limelight was grabbed by the 15Y MGS 11/33 (ex-benchmark only recently replaced by the new MGS 7/34) which witnessed one of the highest volumes churned amounting to ~RM4.2b). Large local institutional investors were mainly net buyers for MYR govvies in June followed by offshore parties on purported views of dovish-like statements in US spilling over to EM Asia including Malaysia which outweighed fears on matters below:

- The recent US Treasury Department's Semi-Annual Currency report, stating that Malaysia along with eight (8) other countries were placed on the US Treasury's Monitoring List that warrants close attention for their currency practices and macroeconomic policies.
- Norway's US$1.0 billion Sovereign Wealth Fund (SWF) plans to omit emerging market (EM) bonds from its fixed-income benchmark.
- FTSE Russell placing Malaysia on the watch list for potential exclusion from the World Government Bond Index (WGBI) in September.

Despite the above, the month under review saw MYR bonds well-bid with yields reaching lower yields of between 10-23bps compared to May as both local and some foreign investors showed confidence in the ability of regulators to deepen and provide better liquidity in both Bonds and Ringgit.



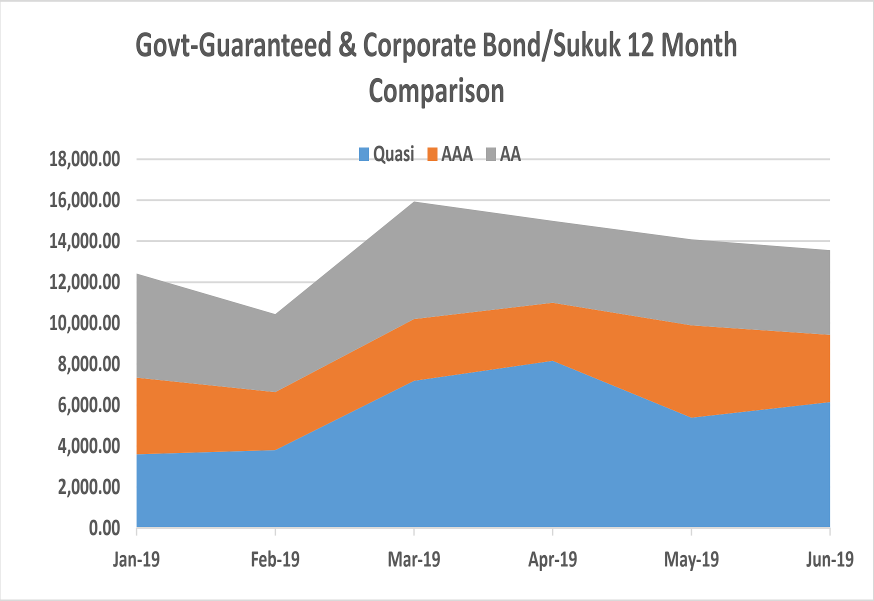
Source : BPAM, Bloomberg, HLB Research

Corporate bonds/Sukuk continue to ramp-up demand…

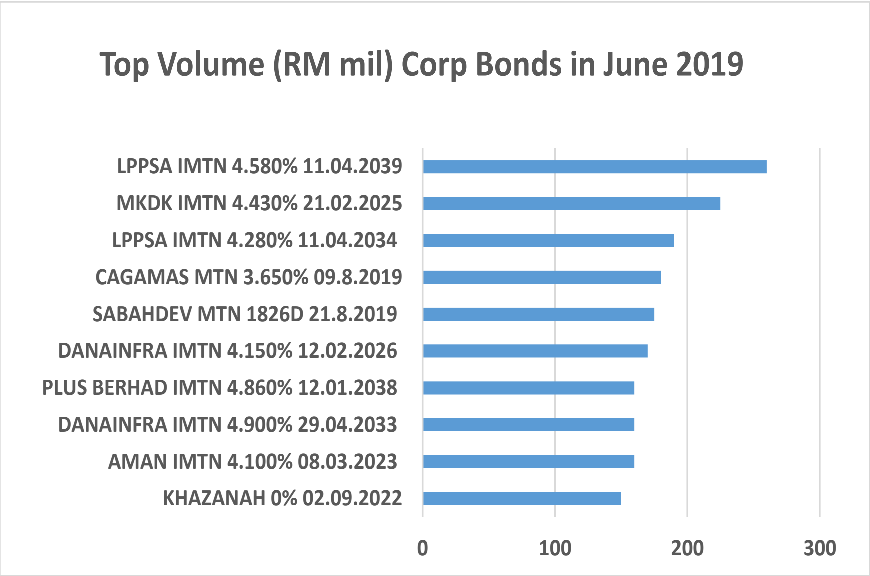
In the secondary market, Corporate Bonds/Sukuk (including Govt-Guaranteed bonds for our ease of classification) saw strong secondary market trading volume on sustained momentum at ~RM14.3b in June; similar to RM14.5b prior month. Demand was mainly from local fund managers/portfolio investors that continued to actively bid in the secondary market for yield spreads with relatively decent liquidity on quality credits rated AA and above. Elevated and persistent global trade tensions and anticipated slowdown in global growth has ignited the likelihood of a US rate cut based on recent dovish-like statements from Fed Chair Powell. This has sparked a global rally most of which saw spillover into Corporate Bonds/Sukuk in June.

Investor appetite for GG saw stronger traction MOM; increasing to 45% in June (May: 38%) whilst AAA-rated bonds dropped from 32% to 24% of overall transactions partly due to lack of GG bond supply and stickiness for the month. Govt-guaranteed LPPSA 4/39 and MKD KENCHANA 2/25 topped the monthly volume; closing 15bps lower at 4.05% and 18bps at 3.72% respectively for the month compared to previous-done levels. This was followed by another GG bond i.e. LPPSA 4/34 and short-tenured AAA-rated CAGAMAS 8/19 which rallied 40bps to close at 3.20% and LPPSA 4/34 which also saw yields decline by 16bps to 4.05%.

Appetite in the credit space was mainly seen in a wide range of bonds namely infrastructure-related names including telecommunication, toll and energy sub-sectors. AAA-rated TELEKOM 23-28, PLUS 21-36, SARAWAK HIDRO 24-31, DANUM Capital 23-34 together with AA-rated KESTURI 20-32, DUKE/LDF 26-39, JEP 24-32, EDRA Energy 25-38, YTL Corp 26-36 and YTL Power 23-28 continued to see active trading.. In the banking space, decent frequency of trades were noticed for both SABAHDEV, KRUNG THAI, AMBANK and BPMB 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 June boosted by the following names:

Notable issuances in June-19	Rating	Amount Issued (RM mil)
CIMB Group Holdings Berhad	A1	1,000
CIMB Group Holdings Berhad	AA1	1,000
Great Realty Sdn Berhad	AAA	19
Hong Leong Bank Berhad	AA1	1,000
Hong Leong Financial Group Berhad	AA2	1,100
Hong Leong Investment Bank Berhad	NR	100
Hong Leong Islamic Bank Berhad	AA2	400
KYS Assets Sdn Berhad	NR	30
Liziz Standaco Sdn Berhad	NR	34
Malayan Banking Berhad	AAA	17
Opulence Synergy Berhad	NR	1,100
Pengurusan Air SPV Berhad	AAA	1,100
Perbadanan Kemajuan Negeri Selangor	AA3	120
PNB Merdeka Ventures Sdn Berhad	NR	380
Potensi Angkasa Sdn Berhad	NR	23
Sabah Credit Corporation	AA1	70
Sports Toto Malaysia Sdn Berhad	AA3	255
Touch Mobile Sdn Berhad	NR	50
YTL Corporation Berhad	AA1	500
YTL REIT MTN Sdn Berhad	NR	85
		8,383

Source : BPAM, Bloomberg, HLB Research

Total fresh issuances of all ratings of Corp Bonds/Sukuk reverted to realistic levels of ~RM8.3b (May: RM31.6b due mainly to issuances of ~RM27.0b by Urusharta Jamaah; an SPV by FELDA). Again, there were no GG issuances back-to-back in May and June as PASB's bond issue was rated AAA. The prominent issuance involved mainly banks i.e. CIMB Group and HONG Leong banking group which altogether excited credit investors with ~ RM4.6b in total consisting of Perps, 1-3Y (CIMB) and 10Y bonds (Hong Leong).

Outlook for July

Investors will be looking to seek emerging values whilst adding on positions…

The weighted average BTC for the two (2) auctions in June improved to a solid 3.08x mainly due to the strong 20Y GII bond auction (May: 2.64x). The MYR bond market was well-bid and is expected to hold steadfast on safe-haven bids; following the trend in many EM and global bond markets. BNM's decision to stay pat on the OPR at the recent MPC meeting as policy makers do not see inherent weakness in the economy. To re-cap BNM has reiterated that the stance of monetary policy remains accommodative and supportive of economic activity. The MPC will continue to assess the balance of risks to domestic growth and inflation, to ensure that the monetary policy stance remains conducive. This is still seen to provide support to the local bond market. The USDMYR pair has strengthened to 4.1200 levels at the time of writing from recent 4.1900 levels a result of USD weakness. While this should augur well with MYR bonds, its future direction is still subject to uncertain trade and portfolio flows going forward.

The challenges for Malaysia's bond market in 2019 has so far been based on "external noises"; mainly emanating from the US Treasury Department's Semi-Annual Currency report, for which Malaysia along with eight (8) other countries were placed on the US Treasury's Monitoring List warrants close attention for their currency practices and macroeconomic policies. (The other countries include China, Japan, Korea, Germany, Italy, Ireland, Singapore and Vietnam). Earlier in April, the Norwegian sovereign wealth fund's reputed reduction in exposure to emerging market bonds is expected to be gradual with the fund's exposure to Malaysian govvies at US$1.96 billion (RM8 billion). Norway's sovereign wealth fund will streamline its US$300 billion (RM1.23 trillion) fixed-income portfolio by cutting emerging market bonds from the benchmark index it tracks. Currently worth US$1.05 trillion (RM4.31 trillion), Norway's Government Pension Fund Global has invested around 30% into fixed income with the balance 70% invested in equities. In terms of size, Malaysia is the third largest country with exposure to the fund after South Korea and Thailand. Likewise, Malaysia could also face an outflow risk of about US$4 billion by passive funds and an additional US$2-4 billion by active funds, should FTSE Russell drop Malaysian bonds from the World Government Bond Index (WGBI). If FTSE Russell decides to remove Malaysia from the WGBI in September this year (currently the WGBI index excludes GII bonds). This could translate into a potential outflow risk of US$6-8 billion, or about RM24-33 billion.

As the OPR stays pat, some parts of the curve are seen to exhibit kinks. There is RM8.4b worth of maturities for MYR govvies in July unlike June. Both the 7-9Y and 20Y MGS bonds offer better values whilst valuations are slowly reverting to "realistic" levels in the 10Y space. Likewise we prefer the 5Y space for GII bonds. Demand for Ringgit Corporate Bonds/Sukuk along the GG segment will continue to be strong (currently compressed at 10-19bps spreads to MGS) considering limited and/or supply constraints. Expect some spillover to the AAA and AA-rated space with interests in utilities and energy-related names as these provide decent "risk-reward" with liquidity and partial inelasticity feature due to the captive primary market mainly by local institutional investors.

Fed dot plot still shows a pause for 2019 but bond traders expect rate cuts going forward…

The UST rally in June saw an almost parallel shift lower for the curve with the UST 10Y saw a tighter trading range of 18bps (May: 51bps) as the bond market continued to rally on expectations of an interest rate cut by the Fed. However there seems to be "tug of war" between the case for no cut based on:

- Fed Dot Plot largely poised for a pause
- Strong labor market (refer June NFP)

versus a cut based on:

- Removal of the "patience" stance in the Fed's minutes
- Low and muted inflation
- Global uncertainties on economic growth due to trade-related issues
- Dovish-dissenters i.e. Fed member Bullard

Variables that bond traders use to compute yields i.e. growth expectations, inflation expectations, outlook for monetary policy and the term premium may signal trouble for bond bears. The Fed will be looking at growth, job creation, wages and inflation whilst keeping an eye on trade matters with China, Europe and also other events like BREXIT. Nevertheless UST's may find support under the current dovish-like situation for 2019 amid muted inflation and softer global growth. Futures traders may be seen to reduce their "short-positions" instead compared to the rather high primary dealer holdings for now**.** The US yield curve has been inverted on the front-end for a full month now with the 3m10y spread at it widest and is supposedly an accurate recession predictor.

The belly potentially offers decent reward than short-term funds as the US yield curve remains inverted and there may still be room for lower rates as markets continue to price in Fed's likelihood of easing interest rate policy. The 10Y is expected to range between 2.00-2.20% whilst finding support at 2.20% levels.

In the Credit/Corporate space, investors may still find Investment Grade issuances to offer decent spreads of ~ 114bps which potentially undergo less stress. We prefer to avoid the HY sector due to potential stretched balance sheets in light of the late credit cycle despite the quiet maturity calendar ($9b due in 3Q2019 versus $20b for 2H2019).

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