Global Markets Research

Fixed Income : Research Alert

Status quo for MYR Govvies weightage in FTSE Russell WGBI

FTSE Russell; has **MAINTAINED Malaysia in its watch-list** for possible downgrade or exclusion from its World Government Bond Index as per its earlier stance last April 2019. We opine that initial fears are overblown over the reduction in weightage or even removal of Malaysia entirely from the FTSE Fixed Income Country Classification March 2020 Interim Update (i.e. FTSE Russell World Government Bond Index) which was published following the US market close on Thurs, 2nd April. This would mean that the FTSE Russell team is confident that the Malaysian government is still in the midst of taking strong initiatives and measures to ensure it remains anchored in the index by September 2020.. **Expect minimal impact on MYR govvies; mainly MGS as investors weigh attractive safe-haven yield-carry options versus the onslaught of negative-yielding global debt. In conclusion, we opine that buying opportunities exist and will largely be due to a favorable comparative regional valuation.**

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Following the announcement sometime in April 2019; investors and market participants have been blowing hot and cold over the potential changes in weightage allocation and even fearing the worst over a complete exclusion of MYR govvies in the said index. To re-cap, qualification for the FTSE WGBI encompasses three (3) criteria, for which Malaysia has successfully adhered to.

1. Issuances must have a minimum market size of USD50b, EUR40b or JPY5 trillion.
2. Issuances must have a minimum credit quality of A- by S&P and A3 by Moody's
3. Issuances must have a minimum market accessibility of "2" based on various categories under market, macroeconomic & regulatory environment, forex structure, bond market structure and global settlement & custody

Nevertheless concerns regarding item (3) above with regard to "accessibility" were raised causing the Malaysian government to subsequently engage with the FTSE Russell team on deepening the onshore markets and providing much-needed liquidity via:

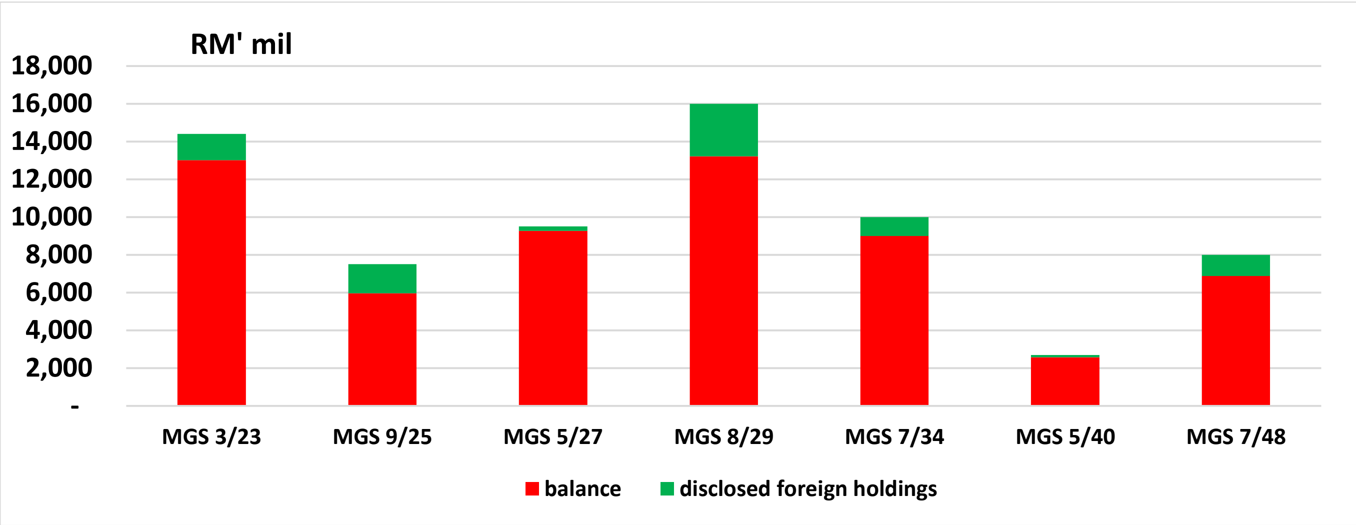
- 2-way quotes including for non-benchmark bonds
- ensuring inter-bank principal dealers and large institutional participation in local govvies
- improved auction calendar offering more re-openings of prior issues
- vibrant repo market
- establishing a debt management office i.e. appointed overseas offices
- improving MYR accessibility after onshore trading hours
- To allow for the expansion of hedging programs.

Note that Malaysia which was included in the WGBI since 2004 was assigned a "2" and sits in both the FTSE WGBI & FTSE EMGBI. For the FTSE WGBI, the five (5) categories constituting the entire index are US, EGBI (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands and Spain), UK and "all-others". The "all others" category forms 6.26% weightage that includes the following countries: Australia, Canada, Denmark, Malaysia, Mexico, Norway, Poland, Singapore, South Africa, and Sweden. (Switzerland was removed from this index in Sep 2018 due to market size ineligibility). **Drilling down further, Malaysia's weightage in the index is 0.40% as of March 2019.** A weightage or reduction or removal of the nation from the index may trigger the risk of outflows which were reputed to be about $4 billion by passive funds and a further $2 billion-to-$4 billion by active funds

Discussion with global investors reveal that this index has been a decent gauge mainly for specific East Asian investor/s and does not necessarily represent the entire spectrum of global investors. Most portfolio adjustments by fund managers are envisaged to have been taken into account over the past six (6) months and further abrupt selling is not expected in heavy volumes. Note that foreign holdings in MGS had fallen in February by ~US1.7b.

Based on the chart below, current foreign holdings in benchmark MGS are well-spread throughout most maturities save for the 7Y and 20Y whilst concentration risk is minimal. We note the highest percentages lie between 14-20% and focused in the 5Y, 10Y and interestingly in the long-bond.

In conclusion, we opine that buying opportunities exist and will largely be due to a favorable comparative regional valuation.



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 1223/1
Fax: 603-2081 8936
Email: HLMarkets@hlbb.hongleong.com.my

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