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 (WGBI) in its most recent September annual review, no change from its earlier stance since April 2019. We opine that initial fears over the reduction in weightage or even removal of Malaysia entirely from the FTSE Fixed Income Country Classification were shrugged off throughout the past months in lieu of the ramp-up in foreign holdings. 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 the next interim update in March 2021.* ***Expect lesser 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 remain cautiously optimistic that the local regulatory authorities have and will continuously be noted for their pro-active measures to ensure that the nation's bonds remain anchored in the WGBI.***

Expect initial disappointment in the continuance of Rating Watch to wane as investors weigh attractive safe-haven yield-carry options for local govvies (Mainly MGS) versus supply of negative-yielding global debt…

Following the announcement sometime in April 2019; investors and market participants have been fretting over the potential changes in weightage allocation and even fearing the worst over a complete exclusion of MYR govvies in the said index. 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" are expected to be resolved as ongoing efforts by the Malaysian government and regulatory authorities have been lauded by the FTSE Russell team on deepening the onshore markets and providing much-needed liquidity via the following:

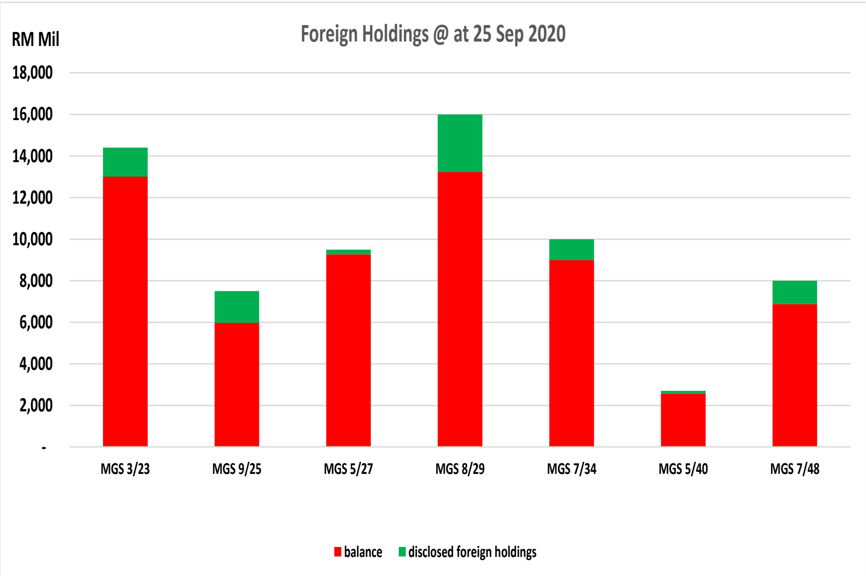
- 2-way quotes including for non-benchmark bonds
- Ensuring inter-bank principal dealers and large institutional participation in local govvies
- Improved auction calendar offering more re-openings of prior issues
- Vibrant repo market especially for MGS market
- Consolidation of bond issuances to increase the outstanding size per issuance whilst reducing the no of issuances
- Introducing MGS futures with physical delivery
- establishing a Debt Management Office
- Enhancing the Forex market by permanently offering Appointed Overseas Office programme (AOO)
- Improving MYR accessibility after onshore trading hours and also allowing Japanese local custodian banks to undertake 3rd party Forex and and dynamic hedging
- To streamline Forex documentation and 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-36.4%, EGBI (Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands and Spain)-33.9%, Japan-17.7%, UK-5.5% and "all-others"-6.5%. The "all others" category which forms 6.5% weightage includes the following countries: Australia, Canada, Denmark, Israel, Malaysia, Mexico, Norway, Poland, Singapore, 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 ~0.41% as of July 2020.** A weightage reduction or removal of the nation from the index may not trigger the risk of outflows which were earlier believed to be as high as ~$4 billion by passive funds and a further $2 billion-to-$4 billion by active funds. From a risk-perspective, decisions to pare down holdings would have long taken place by now.

Discussions with global investors reveal that this index has been a decent gauge mainly for specific East Asian investors and may 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 risen for the past five (5) months i.e. since April 2020 by ~MYR20.2b.

Based on the chart below, **current foreign holdings in benchmark MGS are slightly skewed towards the 5Y, 10Y and interestingly the long-bond with percentages between 14-20%.**

In conclusion, we opine that buying opportunities do exist and will largely be due to a favorable comparative regional valuation. We are optimistic that the next announcement and review in March 2021 will be favorable.



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