Monthly Fixed Income Perspective –

July 22 review & August 22 outlook

US Bond Market

- **In July**, US Treasuries (UST) gained handsomely as the Fed's hawkish rhetoric due to fears of inflationary pressures were overshadowed by economic growth impediments as the Fed raised the Fed Funds Rate again by another 75bps to between 2.25-2.50% in its July FOMC meeting. The curve bull-flattened as benchmark UST yields rallied with yields ending 7-37bps lower, led by the intermediates. **The 2Y UST yield declined 7bps to 2.89% whilst the 10Y declined the most by 37bps to 2.65%.** At the time of writing, these yields have however moved to 3.16% and 2.76% levels, thus reflecting a deeply inverted yield curve which is perceived to be a predictor of a possible recession in the near future. Meanwhile, nonfarm payrolls data revealed that US employers added 528k for the month, recovering the jobs lost at the beginning of the pandemic in 2020.

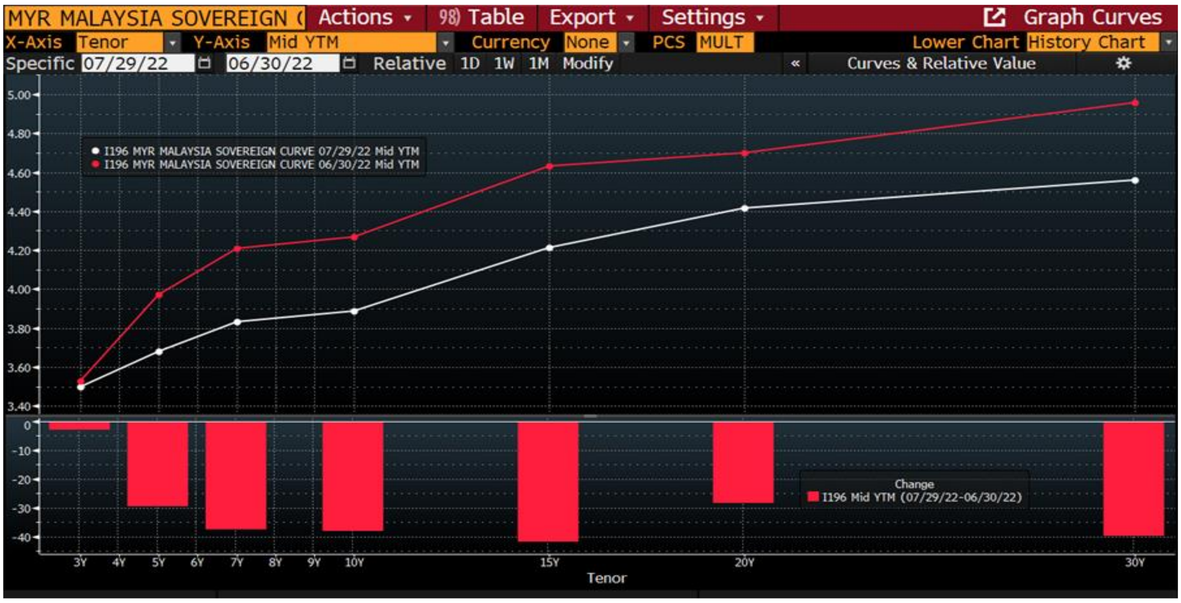
- **For August**, expect UST yields to range sideways-to-lower as the just-released July CPI data revealed a cooling headline inflation (July CPI~ unchanged m/m and +8.5% y/y), despite sticky core inflation of +0.3% m/m and 5.9% y/y). A key gauge of investors' inflation expectations, i.e. the five-year forward breakeven rate, is currently hovering at 2.08%, just beneath where it stood on Feb. 18 and the lowest closing level since early 2021. And while it recovers, the rate is well below the 2.67% high back in April and much closer to the rate of 2.00% that the US central bank tries to anchor its policy around. **The 10-year UST is expected to range slightly lower between 2.80-3.00% compared to our previous month forecast; finding support at key 3.00% levels for this month.** We continue to maintain a neutral-to-slightly bullish view for nominal USTs as we opine that inflation may be peaking soon in the 8.0-9.0% range. We continue to favor MBS which forms the backbone of the USD$9 trillion mortgage market, backed by home loans with payments supported by the US government and also 5-10Y TIPS. We also prefer to ride with IG issuances generally within the shorter duration of between 2-5Y namely in sectors covering energy, capital goods and technology.

MYR Bond Market

- **In July**, overall MYR government bonds outperformed m/m as overall benchmark yields declined between 1-45bps with the intermediates and long-end seeing prominent rallies. **The benchmark 5Y MGS 11/27 yield fell by 25bps to 3.71%, whilst the 10Y MGS 7/32 rallied the most with yields closing 42bps lower at 3.88%.** Foreign holdings of MYR government bonds (MGS + GII + SPK) saw outflows of RM4.7b to RM225.1b (representing 23.0% of total outstanding). The primary factors which drove bond movements were still mainly foreign-led; as fears of potential recessionary conditions overwhelmed aggressive Fed rate hikes due to elevated inflation in the US. The perceived US-China tensions arising from US House Speaker Pelosi's trip to Taiwan after a stop-over in Kuala Lumpur added some flight to safety for bonds as well. The three (3) auctions in July 2022 saw average BTC ratios maintain below the 3.0x handle i.e., at 2.70x (June: 2.69x).

- **For August,** expect some strength in bonds as fears over inflation narrative may have been overdone despite soaring food costs aggravated by the weak MYR and domestic supply chain disruptions. Nevertheless, the tailwind from Finance Minister Tengku Zafrul's view of slower growth in 2023 coupled with the likelihood of a higher dividend payout from Petronas which may result in lower govvies issuances going forward; may lend bonds a bid. **Sukuk/Corporate Bond space is expected to rope in stronger demand as yield pick-up is favored. We expect the 10Y MGS yield to maintain its trading range a tad lower i.e.; between 3.90-4.10% compared to our previous month forecast, with support pegged at 4.10% levels**. The 5-7Y, 20Y sector for both MGS/GII currently reflect value proposition along the curve. In the corporate bonds/Sukuk space, we still favor local bonds tied to tolling, transport/logistics and utilities sector such as electricity/telecommunications/sewerage. Our preferred tenures include i.e., 3Y GG (25bps spreads), 7Y AAA (50bps spread), 7Y AA (65-90bps), 15-20Y AAA (55-60bps) and also 15-20Y AA (~70-100bps).

MYR sovereign curve (MGS)



Source: Bloomberg

NFP soared in July…and may impinge on bonds as the Fed is expected to continue raising interest rates albeit at a less aggressive pace

July Non-Farm Payrolls ("NFP") beat consensus estimates of 250k by notching a monthly gain of 528k, compared to previous month's solid numbers which were revised by 16k to 398k. The biggest job gains occurred in leisure and hospitality (96K), professional and business services (89K), and food and beverages services (74K). Total nonfarm employment has increased by 22.0 million since hitting a trough in April 2020 and has returned to the pre-pandemic level. Meanwhile, the unemployment rate held steady again for the 5th straight month at 3.6%, just a few ticks above the a 54-year low; painting a picture of a still healthy labour market despite back-to-back quarterly GDP contraction. The participation rate inched slightly lower to 62.1% from prior month's 62.2%. The average hourly earnings, a gauge of wage inflation and a key metric tracked by the Fed climbed 0.5% after rising 0.4% in June. That left the year-on-year increase in wages at 5.2% (June: +5.1%, compared with forecasts for a 4.9% rise). Under the backdrop of tight labor market and elevated inflation, fears of possible recession stoked by inflation and an aggressive Fed may be on the back-burner for now.

Moving on to other economic data, the mixed yet persistently expansionary manufacturing PMI for July @ 52.0 (June: 52.7) and ISM manufacturing of 52.8 (June: 53.0) is expected to see elevated demand for goods that are still not readily available due to supply logistics breakdown and bottlenecks in shipments. Separately, the Fed's preferred inflation measure i.e., core PCE in June jumped to 0.6% m/m from prior month's 0.3%, whereas the y/y figures, inched to 4.8% (previous month 4.7%). With both the headline and core numbers pressing higher with persistent inflationary pressures, there may not yet be any respite for now with UST and corporate bond yields impinged higher going forward.

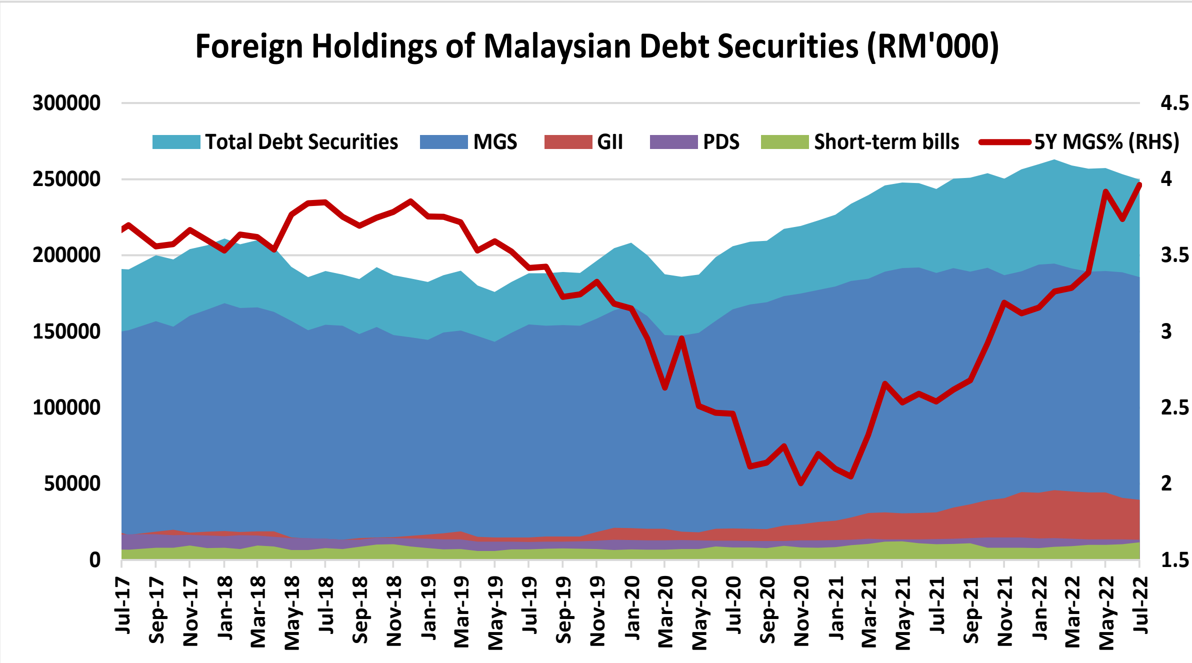
The Fed lifted the Fed Fund Rates for the 4th time at its last FOMC by another substantial 75bps on 28th July (following the first 25bps rate hike on 17th March in 2022, 50bps hike on 5th May and 75bps on 16th June) The Fed's dot plot pins median rates and/or implied Fed Funds rate from 16 officials at average ~3.375% by end of this year; rising through average 3.75% in 2023. Additional data from the Fed Fund Futures now reflect traders' hypothetical expectations of 88% odds of a 75bps rate hike instead in the next FOMC meeting on 21st September whilst CME FedWatch Tool targets a 68% probability of a 75bps rate hike instead. We note that the Fed's ~$8.941 trillion balance sheet as at 6th of July has eased further to $8.9 trillion as at 27th July with ongoing run-off a continuing factor expected to impact the movement of yields.

Foreign holdings of overall MYR bonds saw smaller decrease of ~RM3.5b or 1.4% in July amid weaker Ringgit…

Foreign holdings of overall MYR bonds fell by RM3.5b or 1.4% in July to RM249.8b. Nevertheless, non-resident holdings of MGS fell sharply by RM3.3b (prior month: -RM864m) or 1.7% to RM185.7b, whilst forming substantially lower i.e., 35.5% of total outstanding. This was due to both the twin-effects of lower MGS foreign holdings coupled with higher issuances of MGS. **Total MYR Government bonds (MGS+GII+SPK) holdings saw substantial outflows of RM4.7b to RM225.1b (representing 23.0% of total outstanding) versus prior month's decline of RM4.3b;** despite net maturities of RM3.5b for the month (June: net issuances of +RM15.0b instead). Meantime, **12-month cumulative rolling inflows plunged to RM5.3b (prior month: +RM6.8b).** Foreign participation in auction exercises were mixed (despite the lower foreign holdings) as investors preferred to stay sidelined due to EM bond yields being impacted with concerns over weakening ASIA FX including MYR due to fears of the Fed's hawkish rhetoric to continue on the pathway of rate increases coupled with the balance sheet runoff that commenced since June.

The ongoing Russia-Ukraine war has seen little impact with regards to any correlation in the flow of foreign funds into EM, especially South-East-Asia with impact expected to be felt mainly in the EU. The well-diversified profile and appetite of local investment Institutions namely GLIC's, pension funds, insurance companies and asset management companies will continue to play a prominent factor in providing support in the Fixed Income space whilst smoothening volatilities.

Separately, equity inflows saw a reversal following five months of outflows. June registered a small inflow of RM123.8m (June 2022: -RM1.3b) whilst the 12-month rolling inflows jumped to RM8.6b. On the currency side, the MYR weakened further against USD to 4.4508 as at end July (end-June: 4.4085) and is currently at 4.4495 levels at the time of writing.



Source: BNM, HLBB Global Markets Research

Our house view remains for OPR to be raised by another 25bps to 2.50% supported by improving growth outlook

To recap, BNM at its monetary policy meeting on 6th of July raised the OPR by a further 25bps to 2.25% as expected based on improving growth prospects of the Malaysian economy, and in line with the central bank's earlier guidance back in May for a gradual and measured policy normalization path. It also acknowledged that global growth was driven by economic reopening and recovery in the labor market, but the recovery has been partly curbed by rising cost pressures arising from the Ukraine conflict and supply chain disruption. The domestic economy continued to see positive growth momentum recently, supported by an improving labor market and income level. Domestic demand will be the key growth engine going forward as exports are expected to moderate in line with a softening global economy.

Hence, BNM is seen adjusting the degree of monetary accommodativeness to ensure monetary policy remained supportive of economic growth. A comparatively moderate inflationary condition given the heavily subsidized fuel and consumer staples may allow BNM to make less aggressive moves compared to other central banks. **However, given the growing upside risks to inflation, we maintain our view for a further 25-50bps increase in the normalization of OPR to 2.50-2.75% this year.** This is also to minimize the rate gap with the Fed whilst preserving longer term growth and maintaining price stability**. I**nflation is expected to fall within the upper-end of our forecast range of 2.2-3.2%. Barring significant untoward development on the geopolitical front and a sharp slowdown in the major economies, we continue to expect further pick-up in 2Q and 3Q GDP, reinforced by acceleration in domestic demand with full-year 2022 GDP pegged at 7.4% (2021: 3.7%)

Sustained interest seen for new coupon offerings in July amid RM3.5b excess "maturity over issuance" rollover opportunities…

The three (3) auctions in July 2022 saw average BTC ratios ease but nevertheless maintained solid metrics @ 2.70x (June: 2.69x); well above 2.0x handle. The highest BTC of 3.105x among the three (3) auctions was notched by the re-issuance of 10Y GII 10/32 which saw strong participation from a wide repertoire of participants consisting of GLIC's, pension funds, insurance companies and asset management companies, resulting in a relatively short tail of 1.2bps. The other auctions consisted of the reopening of 20Y MGS 10/42 and the 30Y re-issue of 7Y GII 7/29 which saw decent covers of between 2.40-2.65x. However, the latest auction of the RM5.0b 5Y MGS 11/27 (no private placement) saw decent appetite with BTC at 2.04x with total bis amounting to RM10.2b. Altogether, the three (3) auctions in July mentioned earlier saw individual sum of bids amounting to between RM6.6-10.9b. Since there are RM10.5b worth of maturities in August compared to higher projected issuances of RM15.0b, smooth reinvestments into the MYR government bond space for both fresh auctions and/or secondary market participation may be a telling factor. Our YTD projection of gross issuances of RM105.5.5b is slightly lower than the actual issuances of RM108.5b for 2022. To recap, total govvies maturities for 2022 are RM78.2b (2021: RM73.7b), with our projected gross issuances remaining at RM167.0b for this year.

MGS/GII issuance pipeline in 2022

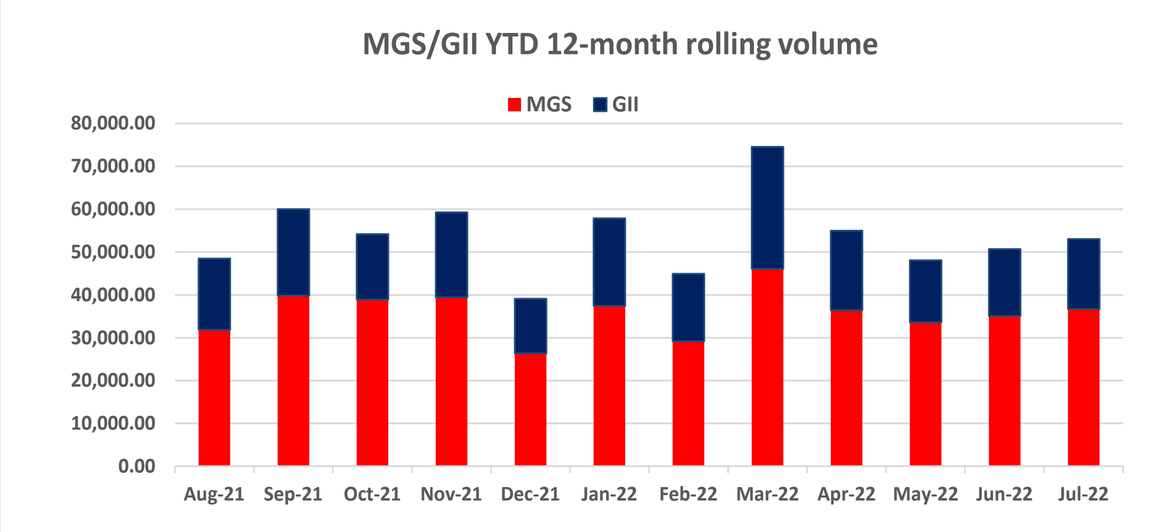
No	Stock	Tenure (yrs)	Tender Month	Quarter	Tender Date	Projected Issuance Size (RM mil)	Actual Auction Issuance (RM mil)	Actual Private Placement	Total Issuance YTD	BTC (times)	Low	Average	High	Cut-off
1	5-yr reopening of MGS (Mat on 11/26)	5	Jan	Q1	6/1/2022	5,000	5,000		5,000	2.329	3.235	3.273	3.290	39.4%
2	10.5-yr new Issue of MGS (Mat on 7/32)	10	Jan	Q1	13/1/2022	4,500	4,500		9,500	2.044	2.615	3.582	3.598	51.6%
3	15-yr Reopening of GII (Mat on 07/36)	15	Jan	Q1	28/1/2022	4,500	3,000		12,500	2.574	4.147	4.161	4.180	30.0%
4	5-yr Reopening of GII (Mat on 09/27)	5	Feb	Q1	7/2/2022	4,500	5,000		17,500	1.733	3.470	3.495	3.512	47.6%
5	30-yr Reopening of MGS (Mat on 06/50)	30	Feb	Q1	14/2/2022	4,500	2,500	2,500	22,500	2.423	4.488	4.505	4.520	34.1%
6	7-yr Reopening of GII (Mat on 10/28)	7	Feb	Q1	21/2/2022	4,500	4,500		27,000	1.750	3.587	3.612	3.629	50.0%
7	15-yr Reopening of MGS 04/37	15	Mar	Q1	4/3/2022	4,500	3,000		30,000	1.986	4.048	4.064	4.078	87.6%
8	20-yr Reopening of MGII 09/41	20	Mar	Q1	17/3/2022	4,500	2,500	2,500	35,000	1.884	4.375	4.401	4.427	88.0%
9	3-yr Reopening of MGS 03/25	3	Mar	Q1	30/3/2022	5,000	5,500		40,500	1.666	3.210	3.239	3.255	69.2%
10	10.5-yr New Issue of MGII (Mat on 10/32)	10	Apr	Q2	6/4/2022	4,000	4,500		45,000	2.503	4.165	4.193	4.203	30.7%
11	20.5-yr New Issue of MGS (Mat on 10/42)	20	Apr	Q2	12/4/2022	5,000	2,500	2,500	50,000	1.918	4.653	4.696	4.730	32.0%
12	15-yr Reopening of MGII 07/36	15	Apr	Q2	21/4/2022	4,000	2,500	2,500	55,000	1.879	4.750	4.826	4.869	50.0%
13	7-yr New Issue of MGS (Mat on 04/29)	7	Apr	Q2	28/4/2022	4,500	5,000		60,000	2.196	4.470	4.504	4.520	96.8%
14	30-yr New Issue of MGII (Mat on 05/52)	30	May	Q2	12/5/2022	5,000	2,500	500	63,000	2.570	5.255	5.357	5.400	49.0%
15	10-yr Reopening of MGS (Mat on 07/32)	10	May	Q2	23/5/2022	5,000	4,500		67,500	2.598	4.243	4.294	4.310	10.0%
16	3-yr Re-issuance of MGII 10/25	3	May	Q2	30/5/2022	4,500	5,000		72,500	3.632	3.511	3.539	3.550	100.0%
17	15-yr Reopening of MGS 04/37	15	Jun	Q2	8/6/2022	4,000	3,000	2,500	78,000	2.211	4.565	4.599	4.618	4.6%
18	5-yr Reopening of MGII 09/27	5	Jun	Q2	22/6/2022	4,000	4,500		82,500	3.133	4.135	4.155	4.167	100.0%
19	30-yr Reopening of MGS 06/50	30	Jun	Q2	29/6/2022	4,000	2,500	2,500	87,500	2.459	4.930	4.959	4.974	30.0%
20	10-yr Reopening of MGII (Mat on 10/32)	10	Jul	Q3	14/7/2022	5,000	3,500	2,500	93,500	3.105	4.090	4.117	4.129	58.3%
21	20-yr Reopening of MGS (Mat on 10/42)	20	Jul	Q3	21/7/2022	5,000	2,500	2,500	98,500	2.656	4.585	4.598	4.607	37.0%
22	7-yr Re-issuance of MGII 07/29	7	Jul	Q3	28/7/2022	5,000	4,500		103,000	2.403	3.900	3.917	3.927	43.3%
23	5-yr Re-issuance of MGS 11/27	5	Aug	Q3	4/8/2022	5,000	5,000		108,000	2.044	3.770	3.798	3.808	38.3%
24	20-yr Reopening of MGII 09/41	20	Aug	Q3		5,000		X						
25	15-yr Reopening of MGS 04/37	15	Aug	Q3		5,000		X						
26	3-yr Reopening of MGII 10/25	3	Sep	Q3		4,500								
27	7-yr Reopening of MGS (Mat on 04/29)	7	Sep	Q3		5,000								
28	15.5-yr New Issue of MGII (Mat on 03/38)	15	Sep	Q3		5,000								
29	3-yr Reopening of MGS 03/25	3	Oct	Q4		5,000								
30	10-yr Reopening of MGII (Mat on 10/32)	10	Oct	Q4		5,000		X						
31	20-yr Reopening of MGS (Mat on 10/42)	20	Oct	Q4		5,000		X						
32	7-yr Reopening of MGII 07/29	7	Nov	Q4		4,500								
33	5-yr Reopening of MGS 11/27	5	Nov	Q4		4,500								
34	30-yr Reopening of MGII (Mat on 05/52)	30	Nov	Q4		4,000		X						
35	10-yr Reopening of MGS (Mat on 07/32)	10	Dec	Q4		4,500								
36	3-yr Reopening of MGII 10/25	3	Dec	Q4		4,500								
	Gross MGS/GII supply in 2022					167,000	87,500	20,500	108,000	PROJECTED TOTAL ISSUANCE SIZE = 167,000,000				

Source: BNM, HLBB Global Markets Research

MGS/GII secondary market activity inched slightly higher in June…

Trading volume for MYR govvies i.e.; MGS + GII + SPK bonds rose 5.0% m/m to RM53.2b in July compared to prior month's RM50.8b in June. Volatilities seen post 75bps hike at both the US FOMC coupled with the 25bps hike at the Malaysia BNM MPC meeting in July saw mainly local investors nibbling in the secondary market in view that the Fed may pause its aggressive tightening measures and trigger an economic slowdown instead with the US yield curve (denoted by the 2s10s spread) inverting deeper during the month. Also, the statement that Petronas may increase its dividend payout to the government in 2022 may result in lower government issuances. The earlier perceived challenges on bond yield movements following the commencement of the Fed's balance-sheet runoff in June may have seen lesser impact than previously thought. Foreign participation in tenures other than the shorter-tenured off-the-runs were muted for the month in review. The dearth of local market-related news was not unexpected. However, bouts of volatility influenced by both intermittent profit-taking activities and also MYR IRS movements ensured trading opportunities in in the secondary market. Activities were still led and supported mostly by local institutions that included pension funds, inter-bank participants, pension funds, local GLIC's and also real money investors. Some notable developments during the month under review were as follows:

- Both MGS and GII curves were flatter whilst shifting down in parallel mode, extending out from 3Y (save for the 20Y sector which narrowed). The largest deviation yield-wise was seen in the 10-30Y sector for both.
- MYR IRS fell 16-22bps for 2-3Y tenures whereas tenures extending out from 4Y onwards ended between 31-38bps lower.
- Bulk of the volume was seen in the short-ends such as MGS 8/22, 9/22, 3/23, along with benchmark 10Y MGS/GII.



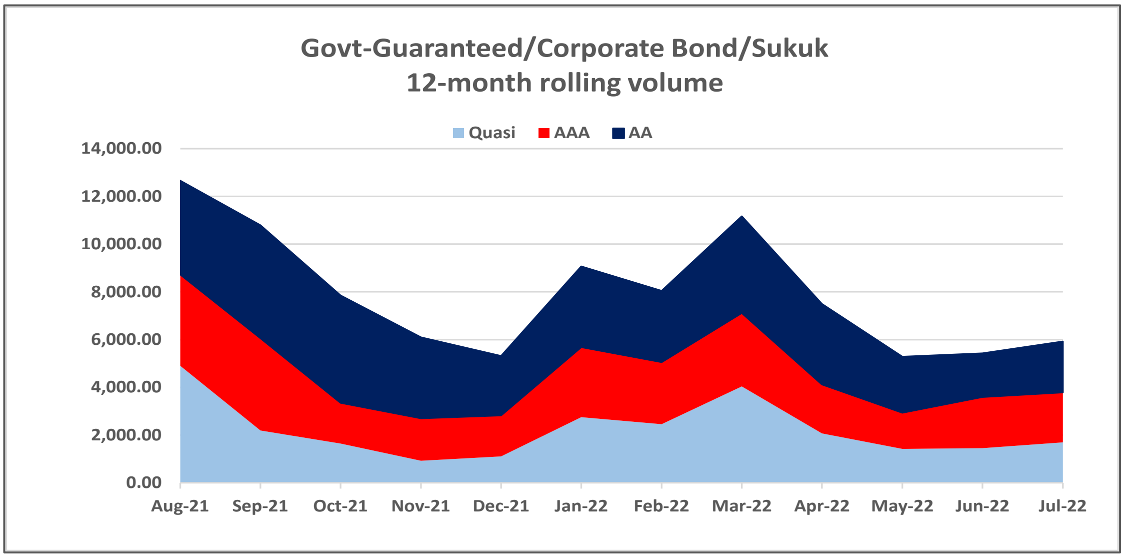
Source: BPAM, Bloomberg, HLBB Global Markets Research

Corporate Bonds/Sukuk saw improved appetite in July…

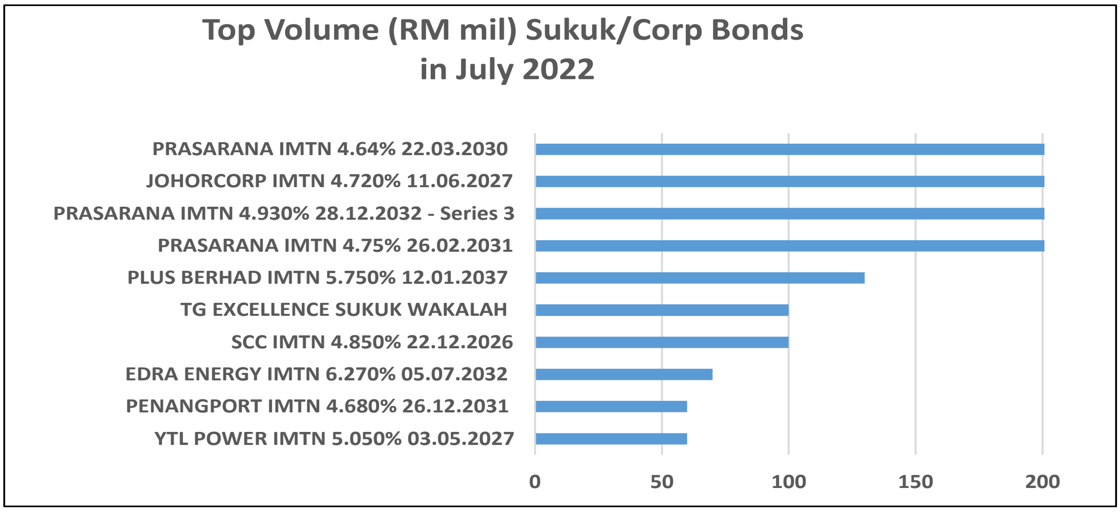
Overall Corporate Bonds/Sukuk (including Govt-Guaranteed bonds) also took cue from govvies and saw trading volume inch higher by 9.5% in the secondary market to RM6.46b in July (June: RM5.90b). The slightly better appetite and momentum was due to yield-carry requirements by the well-diversified base of mainly local investors. Lower primary issuances for the month also boosted interest in secondary market. The Govt-Guaranteed (GG)-segment saw the 5-20Y tenures tightening the most between 27-41bps to between 3.99-4.80%. The AAA-rated space similarly saw tenures between 7-20Y cheaper between 24-31bps; with levels around 4.44-5.10%. The AA2-segment saw yields settle higher between 18-23bps also for 5-20Y tenures; resulting in yields closing within the ranges of 4.49-5.39% area. The sweet spot area was seen in the 10Y sector overall which rallied the most. We note that foreign holdings for both GG and pure credits eased by RM187m to RM13.2b.

Total transactions for GG bonds in June inched slightly higher to form 28.7% (June: 26.7%) of overall volume. AAA-rated papers too saw total trades rise from 26.7% in June to form share of 35.2% of overall trades. The AA-space similarly saw its market share increase with secondary market trades at 36.2% share of overall investor interest (June: 33.7%). The GG-space was spread among names like DANAINFRA and PRASARANA. **Bonds that garnered top volume for the month were PRASA 3/30 (GG) that spiked 39bps compared to previous-done levels at 4.13%, followed by JOHORCORP 6/27 (AAA) which declined 11bps instead to 4.61% and subsequently PRASA 12/32 (GG) which closed unchanged at 4.60%.**

Frequency and volume of bond trades in the credit space were mainly seen in conglomerates like DRB-HICOM 25-31's, MMC Corp 23-28's, Khazanah-related SPV's (i.e. DANUM 23-29's), INFRACAP 24-31's, construction/property entities like UEM Sunrise, PKNS 23-24's), toll-operator i.e. PLUS 23-37's and utilities i.e. telco/water/power (i.e. Air Selangor 28-42's, PASB 22-29's, TENAGA 29-47's, YTL Power 23-27's, Southern Power 26-34's, EDRA 23-33's, BGSM 23-27's, TBEI 26-31's, P METAL 24-25's, PONSB 27-29's, UMW 22-26's and perps. The banking/finance sector saw trades in CIMB bonds. There were frequent odd-lot denominated trades in ALLIANCE Bank 2030, 2032 callable bonds, AFFIN Bank 2032 callable bonds and perps, Genting-related bonds, SABAH Development Bank 23-27's, LBS Bina perps, Eco World 23's and Eco Capital 24's, TG Excellence perps, YNH Property perps, Tropicana 23-28's and its perps.



Source: BPAM, Bloomberg, HLBB Global Markets Research



Source: BPAM, Bloomberg, HLBB Global Markets Research

Primary issuance prints in July driven by the following:

Notable issuances in July-22	Rating	Amount Issued (RM mil)
PR1MA Corporation Malaysia	GG	500
Pengurusan Air Selangor Sdn Berhad	AAA	900
Cagamas Berhad	AAA	1,400
Public Islamic Bank Berhad	AAA	500
Sarawak Petchem Sdn Berhad	AAA	4,000
AEON Co. (M) Berhad	AA2	170
Kedah Cement Sdn Berhad	AA3	100
Affin Bank Berhad	A1	500
Bank Muamalat Malaysia Berhad	A3	300
Danum Sinar Sdn Berhad	NR	5
Hektar Black Sdn Berhad	NR	126
MEX I Capital Berhad	NR	1
Naza TTDI Capital Berhad	NR	28
Sunway Treasury Sukuk Sdn Berhad	NR	160
Tumpuan Azam Sdn Berhad	NR	15
THP Suria Mekar Sdn Berhad	NR	300
XL Holdings Berhad	NR	7
		9,012

Source: BPAM, Bloomberg, HLBB Global Markets Research

Fresh Corporate Bonds/Sukuk issuances in July plunged by 34.4% from RM13.74b to RM9.01b. Some of the prominent issuances consisted of Sarawak Petchem Sdn Bhd's AAA-rated 3-15Y bonds totaling RM4.0b with coupons between of 4.38-5.50% and PR1MA Corporation Malaysia's Govt-guaranteed 5Y bonds with a coupon of 4.00% respectively.

Outlook for August 2022

Expect USTs to see some volatility with potentially lower yields in August

The Federal Reserve will have its next FOMC meeting on 28th of **September for which we maintain our view of another 75bps rate** hike. The world's central bankers continued tightening monetary policy aggressively in July. The Bank of Canada, for its part, surprised with a 100-bps hike. The ECB raised interest rates by 50bps in its first increase in 11 years whilst the BOE doubled the pace in August and delivered a 50bps rise. The implied volatility, denoted by the ICE BofA MOVE index has eased off from the highs seen during June-July period. The Fed is expected to continue with its ongoing balance sheet run-off exercise and is committed to normalize policy amid a strong job market and the "war" to combat inflation which takes precedence over the "battle" on maintaining economic growth.

Nevertheless, the cooling of the just-released US July inflation data may cap further rises in UST yields. These are expected to undercut the outlook for the policy rate to decline next year which took hold based on weakness in gauges of business activity, housing and consumer confidence. The prominent yield curve inversion denoted by the 2s10s spread has deepened further and is perceived to be an accurate predictor of a looming recession ahead may be on the back-burner for now. The US Treasury is reducing its coupon issuance across all maturities in the 3Q2022, with the largest cut of $2b per month in the 20Y maturities followed by 2Y, 3Y, 5Y and 7Y seeing $1b cut per month for the next three (3) months. Swaps traders now continue to price-in anticipated rate hikes of up to another ~110bps in arriving at an implied rate of ~3.45% levels as at end-2022. **Hence, expect the yield curve to potentially shift slightly lower as concerns abate slightly over aggressive rate hikes following the cooling of US July inflation data with focus on signs of economic stagflation following the technical recession seen in 1H2022.** The likelihood of a 75bps rate hike in the upcoming FOMC meeting in September is expected to be digested and have limited impact on USTs and other global sovereign and corporate bond yields.

In the Credit/Corporate space, the Bloomberg Barclays US Corporate Total Return Value (for Investment Grade or IG) reversed into a gain of 3.24% in July (May: -2.80 %); amid the tightening in OAS spreads from 150bps in June to 140bps in July. Concerns over potential recessionary economic conditions in the future impacted drove slightly higher investor appetite. The Bloomberg Barclays US Corporate High Yield Total Return Index (for High Yield or HY) also recorded a strong gain of 5.90% for July 2022 whilst spreads fell sharply lower by 100bps instead to 430bps. The high-yield primary market has slowed to a trickle as borrowers remain on a wait-and-watch mode ahead of the next Fed meeting. Issuance so far this year stands at $69 billion, a 77% plunge from about $301 billion issued from the same period last year.

Our monthly fundamental view suggests the 10-year yield should ease to lower levels. **The 10-year UST is expected to range slightly lower between 2.80-3.00% compared to our previous month forecast; finding support at key 3.00% levels for this month.** We continue to maintain a neutral-to-slightly bullish view for nominal USTs as we opine that inflation may be peaking soon in the 8.0-9.0% range. We maintain a slightly neutral-to-bullish view for nominal USTs as the Fed lifts its pedal off the floor in "battling" the inflation narrative at the expense of growth. We continue to favor MBS which forms the backbone of the USD$9 trillion mortgage market, backed by home loans with payments supported by the US government and also 5-10Y TIPS. We also prefer to ride with IG issuances generally within the shorter duration of between 2-5Y, as spread and yield curves remain steep at this part of the curve relative to the longer-ends; namely in sectors covering energy (which has been consistently providing added compensation per unit of duration), capital goods (favorable roll-downs) and technology.

Local govvies may similarly see yields range sideways-to-lower with trading opportunities…

The MYR bond market saw average BTC ratios for the three (3) auctions in July 2022 ease but nevertheless maintained solid metrics @ 2.70x (June: 2.69x); well above 2.0x handle. The higher-than-expected reopening totaling a whopping RM6.0b consisting of RM3.5b (+RM2.5b private placement) of upcoming 20Y GII 10/41 on 13th of Aug is expected to be well-absorbed by the well-diversified profile of mainly local institutions with solid primary bond appetite. Elsewhere, the ongoing Russia-Ukraine war is expected to have minimal impact than previously thought. The government's focus on taming inflation and mitigate the high cost of living is expected to see a spike in bills which was reported to have hit RM77bn currently.

The pace of US balance sheet runoff is expected to be partially off-set by the lower coupon issuances going forward. Nevertheless, the quantum and number of rate hike exercises in the US based on inflationary conditions is believed to have been priced-into the local govvies space. On the local scene, the net govvies issuances for July month is expected to see a drastic turnaround **to +RM4.5b in August from -RM3.5b in July (maturities > projected gross issuances)**; resulting in the unavailability of smooth spillover of reinvestments to boost liquidity in bonds. Nevertheless, the well-diversified base of investment institutions and active portfolio management activities by fund managers are expected to provide a strong degree of support and stability for bond yields in the secondary market. The current run-rate of our estimated cumulative issuances YTD of RM100.5b is lower than actual issuances of RM103.0b as at the time of writing, underlining the government's strong requirement for issuances to stem the fiscal deficit for capital expenditure programs.

Barring significant deterioration on the geopolitical front and a sharp slowdown in the major economies, **we continue to expect a pick-up in 2Q and 3Q GDP, underpinned by favorable domestic demand with full-year 2022 GDP pegged at 7.4% (2021: 3.7%)**. A comparatively moderate inflationary condition given the heavily subsidized fuel and consumer staples may allow BNM to make less aggressive moves compared to other central banks. **However, given the growing upside risks to inflation, we maintain our view for a further 25-50bps in the normalization of OPR to 2.50-2.75% this year.**

The Sukuk/Corporate Bond space is expected to rope in stronger demand as yield pick-up is favored. We expect the 10Y MGS yield to maintain its trading range a tad lower i.e.; between 3.90-4.10% compared to our previous month forecast, with support pegged at 4.10% levels. The 5-7Y, 20Y sector for both MGS/GII currently reflect value proposition along the curve. In the corporate bonds/Sukuk space, we still favor local bonds tied to tolling, transport/logistics and utilities sector such as electricity/telecommunications/sewerage. Our preferred tenures include i.e., 3Y GG (25bps spreads), 7Y AAA (50bps spread), 7Y AA (65-90bps), 15-20Y AAA (55-60bps) and also 15-20Y AA (~70-100bps).

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