Monthly Fixed Income Perspective –

August 22 review & September 22 outlook

US Bond Market

- **In August**, US Treasuries (UST) had a "torrid" month as the Fed's hawkish rhetoric due to continued fears of inflationary pressures (July CPI data however revealed a "cooler" headline inflation i.e.; unchanged m/m and +8.5% y/y whilst core inflation remained sticky at +0.3% m/m and 5.9% y/y). The scorching jobs market caught a slight chill in August 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 bear-flattened as benchmark UST yields spiked 28-61bps, led mainly by the front and intermediates. **The 2Y UST yield ended 61bps higher at 3.50% whilst the 10Y moved 55bps to 3.20%.** At the time of writing, these yields have however moved to 3.76% and 3.41% levels, despite the perceived indication of a future recession depicted from the inverted yield curve.

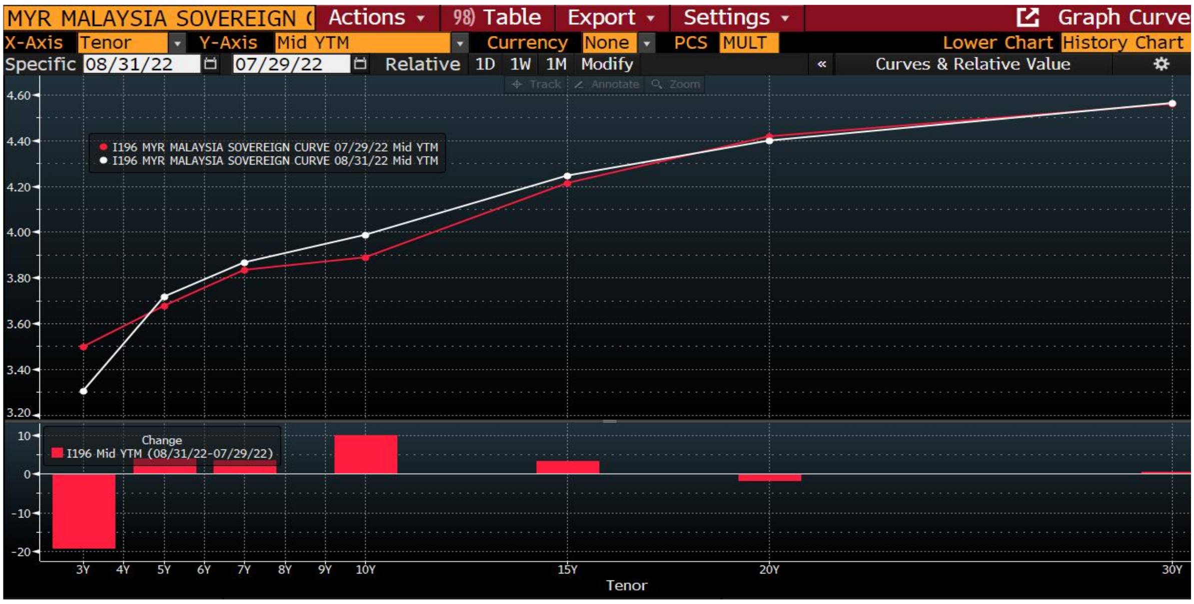
- **For September**, expect UST shorter-ends to be pressured as the Fed emphasized stickiness in inflation and that short-rates to may stay higher for longer based on latest August inflation data release. Meanwhile, nonfarm payrolls data which notched steady numbers of +315k in August, recovered the jobs lost at the beginning of the pandemic in 2020. Nevertheless, the scorching jobs market which caught a slight chill in August may allow the Fed to second-guess its aggressive rate-tightening modus operandi. A key gauge of investors' inflation expectations, i.e.; the 5Y forward breakeven rate, is currently hovering at 2.50%, above the earlier low of 2.34% in February. The rate is still below the 3.73% high back in March but still away from the rate of 2.00% that the Fed is keen to anchor its policy at. **The UST 10Y is expected to range slightly lower between 3.20-3.40% compared to our previous month forecast; finding support at key 3.40% levels for this month.** We continue to maintain a neutral-to-slightly bullish view for intermediate nominal UST tenures (as we opine that inflation may have peaked following the just-released August headline data @ 8.3% y/y and 0.1% m/m). We also favor HY bonds that offer some value as a buffer against rising benchmark rates as investors are not pricing in a deep recession.

MYR Bond Market

- **In August**, overall MYR government bonds were slightly pressured m/m (save for the short-end), especially in the intermediate tenures as overall benchmark yields closed mostly mixed-to-higher -14 to +9bps across. **The benchmark 5Y MGS 11/27 yield rose 4bps to 3.71%, whilst the 10Y MGS 7/32 spiked the most with yields closing 9bps higher at 3.97%.** Foreign holdings of MYR government bonds (MGS + GII + SPK) saw **inflows 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 re-emergence of Fed's hawkish statement at the Jackson Hole and Fed officials overwhelmed earlier views of economic repercussions due to aggressive rate hikes. Elsewhere, the three (3) auctions in August 2022 saw average BTC ratios maintain above the 2.0x handle i.e., at 2.29x (July: 2.70x).

- **For September,** expect some slight strength to prevail in bonds as fears over inflation narrative may have been overdone by the weak MYR and domestic supply chain disruptions. The sustained strength in the GDP along with the weaker MYR may prompt portfolio investors to embark on bond purchases. **The Sukuk/Corporate Bond space will continue to see stronger demand as yield pick-up is favored whilst credit quality remains steadfast in the current strong economic climate. We expect the 10Y MGS yield to maintain its similar trading range between 3.90-4.10% as per our previous month forecast, with support pegged at 4.10% levels**. The 5-10Y and 15Y sectors for both MGS/GII currently reflect some value proposition along the curve. In the corporate bonds/Sukuk space, we still favor local bonds tied to power generation, selective highway operators, transportation, logistics that include port operators and utilities sector such as electricity, telecommunications and sewerage. Our preferred tenures include 15Y GG (20bp spread), 7-10Y AAA (47-48bps spread) and 7-10Y AA2 (76-79bps).

MYR sovereign curve (MGS)



Source: Bloomberg

NFP pulled-back in August but nevertheless indicated resilient job market despite overall economic contraction in 1H2022; interest rates still expected to rise but at a less aggressive pace

Despite lower numbers, August Non-Farm Payrolls ("NFP") beat consensus estimates of 298k by notching a monthly gain of 315k, compared to previous month's solid numbers which were revised by 2k higher to 526k. The job gains were strong especially in professional and business services, healthcare and retail. occurred in leisure. The number of open jobs in August were 11.2m versus 5.7m unemployed. Meanwhile, the unemployment rate rose to 3.7% in August from a 50-year low of 3.5% in the prior month; still reflecting healthy labor market despite back-to-back quarterly GDP contraction. The participation rate, however rose to 62.4% from prior month's 62.1%. More workers joining the labor force could help sustain job growth in the coming months. The average m/m hourly earnings, a gauge of wage inflation and a key metric tracked by the Fed climbed a mere 0.3% after rising 0.5% in July. That left the year-on-year increase in wages at 5.2%, nearly the same as in July; compared with forecasts for a 5.3% rise. The tightness in labor market and elevated inflation may continue to overwhelm concerns over repercussions pertaining to economic contraction going forward.

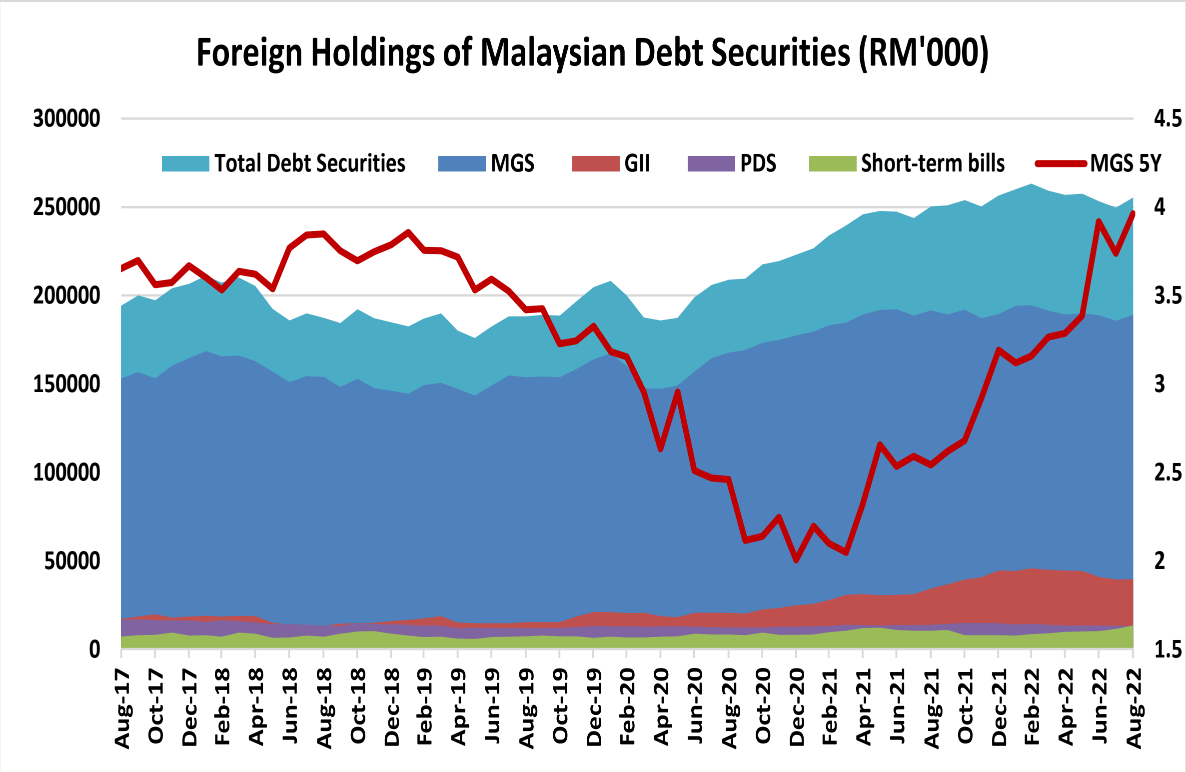
Moving on to other economic data, the strong expansionary conditions in both the manufacturing PMI for August @ 51.5 (July: 51.3) and ISM manufacturing sustenance at 52.8, is expected to see supply trying hard to match up to persistently elevated demand for goods that are still struggling to be delivered to supply logistics breakdown and bottlenecks in shipments. Separately, the Fed's preferred inflation measure i.e., core PCE in July eased glaringly to +0.1% from prior month's rise of 1.0%, whereas the y/y figures, inched lower to 4.6% (previous month 4.8%). With both the headline and core numbers showing slight easing of inflationary pressures, there may possibly be some form of respite for now with UST and corporate bond yields stabilizing going forward.

The Fed lifted the Fed Fund Rates for the 4th time at its last FOMC by another substantial 75bps on 28th July (for the record there were three earlier hikes i.e.; consisting of 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 3.75% in 2023. Additional data from the Fed Fund Futures now reflect traders' hypothetical expectations of 71% of 100bps rate hike (95% odds of a 75bps rate hike) instead in the next FOMC meeting on 21st September whilst CME FedWatch Tool targets a 36% probability instead of a 100bps rate hike (65% odds of a 75bps rate hike). Elsewhere, we note that the Fed's ~$8.89 trillion balance sheet as at 25th of July has eased further to $8.87 trillion as at 29th August with the ongoing run-off a major factor expected to impact the movement of yields.

Foreign holdings of overall MYR bonds reversed to post a huge jump of RM5.6b or 2.2% in August despite weaker Ringgit…

Foreign holdings of overall MYR bonds jumped higher by RM5.6bb or 2.2% in August to RM255.4b. Non-resident holdings of MGS rose by RM3.5b (prior month: -RM3.3b) or 1.9% to RM189.1b, whilst forming prominently higher i.e., 36.1% of total outstanding. This was due to both the perception that inflation in US may be reaching its peak and that MGS/GII yields are seen attractive a pause in OPR for this year. **Total MYR Government bonds (MGS+GII+SPK) holdings saw substantial inflows of RM4.7b to RM225.1b (representing 23.0% of total outstanding) versus prior month's decline of RM3.6b;** amid net issuances of RM5.0b for the month (July: net maturities of RM3.5b instead). Meantime, **12-month cumulative rolling inflows plunged to RM2.62b (prior month: +RM5.30b).** Foreign participation in auction exercises were better amid the higher foreign holdings as investors nibbled in EM bond yields whilst being mindful of the still weak ASIA FX levels including the MYR. The wide and well-diversified base and appetite of local investment Institutions namely GLIC's, pension funds, insurance companies and asset management companies have, and is projected to play a prominent role in providing support in the Fixed Income space.

Separately, equity inflows saw a reversal following five months of outflows. June registered large inflows amounting to RM1.98b (July 2022: -RM124m) whilst the 12-month rolling inflows jumped to RM9.52b from RM8.59b. On the currency side, the MYR weakened further against USD to 4.4760 as at end-August (end-July: 4.4508) and is currently trading above the 4.50 levels at the time of writing.



Source: BNM, HLBB Global Markets Research

BNM raised OPR by a measured 25bps to 2.50% as expected…

BNM decided to raise the OPR by a further 25bps to 2.50% as widely expected at today's meeting, marking its third straight quarter-point increase since the normalization cycle began in May. The decision is based on continued improvement in growth prospects of the Malaysian economy, which calls for further adjustment in the degree of monetary accommodation. Nevertheless, the domestic economy remained strong and is expected to continue expand, underpinned by private sector spending as income and employment outlook remain positive which shall cushion the expected moderation in external demand.

However, BNM acknowledged that global growth was expanding at a slower rate, weighed down by rising cost pressures, tighter financial conditions and strict containment measures in China. Elevated cost pressures despite easing global supply chain conditions, potential energy crisis in Europe, and sharp tightening in financial market conditions, are key downside risks to contend with. BNM also highlighted that the MPC is not on any pre-determined tightening path, offering hints of a pause even though it reiterated that policy decisions will remain data dependent.

We therefore see the case of a pause in November with the OPR ending at 2.50% for the year as any further policy normalization back to pre-pandemic levels will depend on the sustainability of current growth momentum and inflation trajectory. We remain cautiously optimistic that the Malaysian economy would continue to see further acceleration in economic activities in 2H2022 (driven by domestic demand and partly attributable to statistical distortion); we expect growth to pick up further to double-digit pace in 3Q before normalizing in 4Q. With the economy having expanded by 6.9% y/y in 1H2022, we believe our full year growth projection of 7.4% y/y remains intact (2021: 3.7%).

Strong interest seen for new coupon offerings in August despite net issuances of RM5.0b spurring fresh institutional inflows…

The three (3) auctions in August 2022 saw average BTC ratios ease but nevertheless maintained solid metrics @ 2.29x (July: 2.70x); well above 2.0x handle. The highest BTC of 2.742x among the three (3) auctions was notched by the re-opening of 20Y GII 9/41 which saw strong participation from a wide repertoire of participants consisting of GLIC's, pension funds and insurance companies, resulting in a relatively short tail of 2.5bps. The other auctions consisted of the re-issuance of 5Y MGS 11/27 and the 15Y re-opening of 15Y MGS 4/37 which saw decent covers of between 2.04-2.24x. Altogether, the three (3) auctions in August mentioned herewith saw individual sum of bids amounting to between RM5.6-10.2b. Since there were RM10.5b worth of maturities in August compared to higher actual issuances of RM15.5b, the decent demand for auctions were a positive surprise as additional investments into the MYR government bond space for both fresh auctions and also secondary market participation was a sign of confidence and attraction for yield-hungry investors. Our YTD projection of gross issuances of RM115.5b is slightly lower than the actual issuances of RM118.5b 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	12/8/2022	5,000	3,000	2,500	113,500	2.742	4.383	4.410	4.435	81.4%
25	15-yr Reopening of MGS 04/37	15	Aug	Q3	29/8/2022	5,000	2,500	2,500	118,500	2.244	4.210	4.249	4.272	85.0%
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	93,000	25,500	118,500	PROJECTED TOTAL ISSUANCE SIZE = 167,000,000				

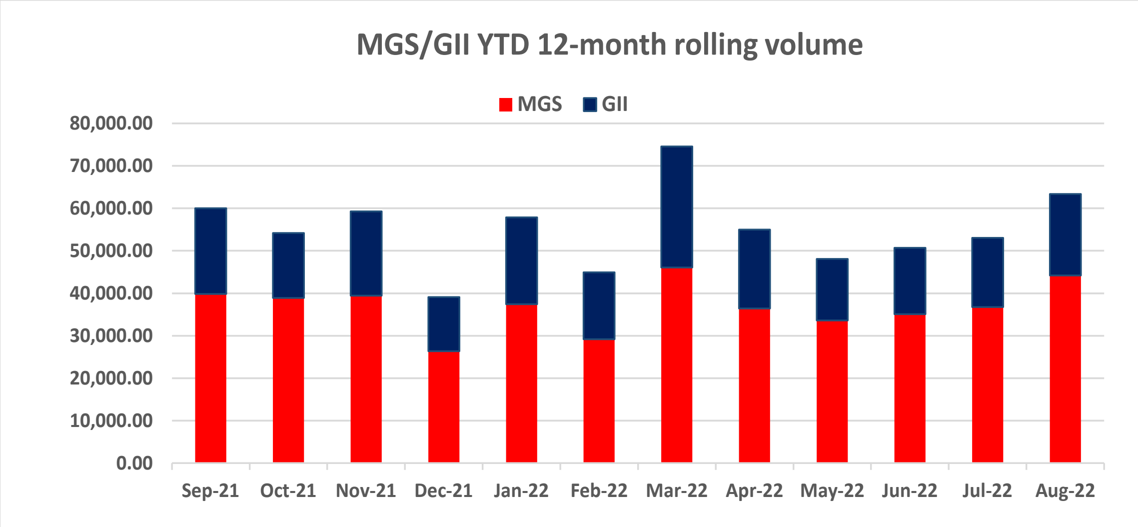
Source: BNM, HLBB Global Markets Research

MGS/GII secondary market activity punches higher in August…

Trading volume for MYR govvies i.e.; MGS + GII + SPK bonds rose 23.7% m/m to RM65.8b in August compared to prior month's RM53.2b. Despite the strong hints by the Fed that may not halt its aggressive tightening measures, the persistent fear over a possible economic slowdown as denoted by the 2s10s spread, boosted investor confidence that global bonds (including MYR) may be reaching its peak. Also, the strength in 2Q2022 Malaysian GDP of 8.9% (y/y) and 3.5% (q/q) was another sign of confidence. Inflation is expected to peak @ 4.0% levels and taper towards the year-end. The Fed's balance-sheet runoff effective June is seen to be less of a concern. Foreign participation in tenures other than the shorter-tenured off-the-runs were seen in the 5Y and 10Y sector as well. There appears to be speculation on an early GE15 following the bringing forward of National Budget 2023 to 7th of October but otherwise the dearth of local-related news in itself may not be able to prompt higher deviation in local bond yields. 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:

- The MGS shifted higher, extending out from 5Y, with the largest deviation yield-wise seen in the 7-15Y sector for both. However, the GII curve ended slightly steeper instead with the 5-10Y sector pressured whilst the long-ends saw yields move lower in larger deviation.
- MYR IRS jumped 13-26bps higher for 1-7Y tenures whereas tenures extending out from 10Y onwards spiked ~25bps.
- Bulk of the volume was seen in the short-ends such as MGS 9/22, 3/23, 8/23, along with the recent re-issue of benchmark 7Y MGS and 10Y MGS/GII.

However, expect bouts of volatility to be influenced by both intermittent profit-taking activities and also MYR IRS movements that may be corelated to interest rate outlook in both the US and in Malaysia. Trading opportunities in the secondary market may be sanguine at best.



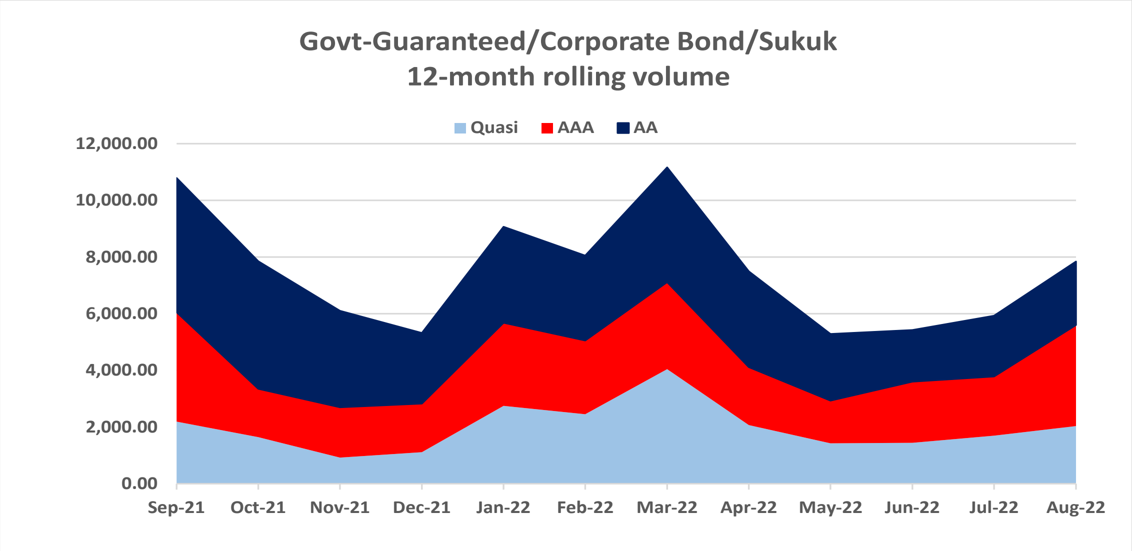
Source: BPAM, Bloomberg, HLBB Global Markets Research

Corporate Bonds/Sukuk saw huge jump in appetite for the month of July…

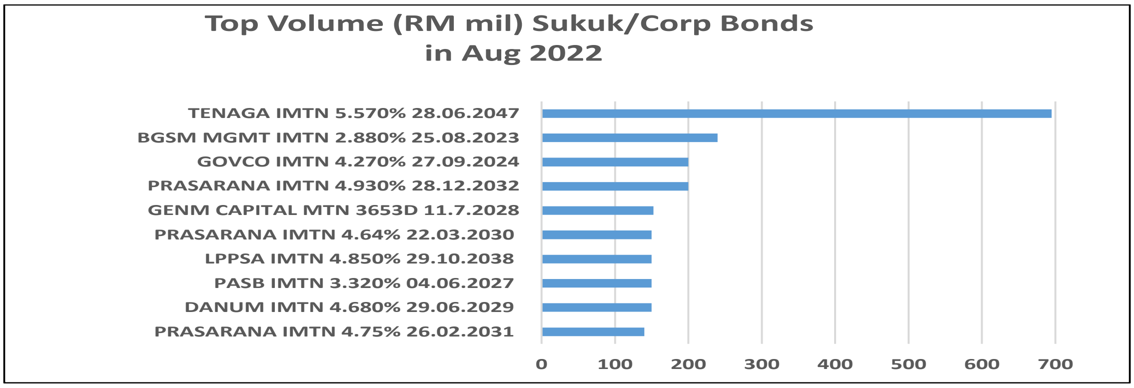
Overall Corporate Bonds/Sukuk (including Govt-Guaranteed bonds) also took cue from govvies and saw trading volume inch higher by 32.0% in the secondary market to RM8.53b in August (July: RM6.46b). The stronger appetite and momentum arose from yield-carry requirements by mainly large base of mainly local institutions. The higher primary issuances for the month did not deter interest in secondary market. The Govt-Guaranteed (GG)-segment saw the 5-10Y tenures widening the most between 5-7bps to between 4.04-4.38%. The AAA-rated space similarly saw tenures between 15-30Y cheaper between 3-8bps; with levels around 4.86-5.07%. The AA2-segment saw yields settle higher between 2-3bps also for 5-15Y tenures; resulting in yields closing within the ranges of 4.49-5.19% area. The sweet spot area is now seen to be in the 10Y sector overall. Elsewhere, we note that foreign holdings for both GG and pure credits climb by RM69m to RM13.3b.

Total transactions for GG bonds in August eased slightly to form 25.9% (July: 28.7%) of overall volume. AAA-rated papers saw total trades jump from 35.2% in July to form share of 45.5% of overall trades. The AA-space similarly saw its market share decrease with secondary market trades at 28.6% share of overall investor interest (July: 36.2%). The GG-space was well-spread among names like DANAINFRA, LPPSA, GOVCO, PTPTN and PRASARANA. **Bonds that garnered top volume for the month were TNB 6/47 (AAA) which rallied with yields closing 37bps lower compared to previous-done levels at 5.15%, followed by BGSM 8/23 (AAA) which debuted at 3.42% and subsequently traded at same levels. Third was GOVCO 9/24 (GG) which closed 8bps lower at 3.60%.**

Frequency and volume of bond trades in the credit space were mainly seen in conglomerates like CAGAMAS 22-24's, conglomerates (like DRB-HICOM 22-28's and perps, MMC Corp 23-28's, Khazanah-related SPV's (i.e. DANUM 23-29's), construction/property entities like UEM Sunrise 22-26's), toll-operator i.e. PLUS 23-37's and utilities i.e. telco/water/power (i.e. Air Selangor 25-42's, PASB 25-29's, TENAGA 29-47's (and its related-companies like TNB Power generation , TNB WE, TNB NE), Sarawak Petchem 25-37's, PONSB 26-29's, EDRA 27-35's, BGSM 22-28's, SEB 27-35's and UITM Solar 23-31's. The banking/finance sector saw trades in BPMB bonds. There were frequent odd-lot denominated trades in ALLIANCE Bank 2030, 2035 callable bonds, AFFIN Bank 2032 callable bonds and perps, MAYBANK 2031 callable bonds, MBSB 27-31's, GENM Cap bonds 25-28's, SABAH Development Bank 22-25's, UOB 2028, 2031 callable bonds, IJM perps, LBS Bina perps, Eco World International 23's and Eco World Capital 26's, 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 August driven by the following:

Notable issuances in Aug-22	Rating	Amount Issued (RM mil)
APM Automotive Holdings Berhad	AA2	50
BGRB Venture Sdn Berhad	NR	4
BGSM Management Sdn Berhad	AA3	350
Cagamas Berhad	GG	1,610
DanaInfra Nasional Berhad	GG	1,600
Danum Sinar Sdn Berhad	NR	9
DRB-Hicom Berhad	A3	350
Ekovest Berhad	NR	130
F&N Capital Sdn Berhad	AAA	110
Fairview Valley Sdn Berhad	NR	360
Hotel Equatorial (M) Sdn Berhad	NR	58
Bank Islam Malaysia Berhad	AAA	500
Lembaga Pembiayaan Perumahan Sektor Awam	AAA	4,000
Maxis Broadband Sdn Berhad	NR	200
Paramount Capital Resources Sdn Berhad	NR	82
Perbadanan Kemajuan Negeri Selangor	AA3	80
Prasarana Malaysia Berhad	GG	1,500
Sabah Credit Corporation	AA1	200
Small Medium Enterprise Development Bank Malaysia Berhad	AAA	500
Tanco Holdings Berhad	NR	3
Tumpuan Azam Sdn Berhad	NR	20
Tomei Gold & Jewellery Holdings (M) Sdn Berhad	NR	40
Tanjung Pinang Development Sdn Berhad	NR	29
West Coast Expressway Sdn Berhad	NR	7
		11,792

Source: BPAM, Bloomberg, HLBB Global Markets Research

Fresh Corporate Bonds/Sukuk issuances in August jumped by 30.9% from RM9.01b to RM11.79b. Some of the prominent issuances consisted of LPPSA's govt-guaranteed 3-30Y bonds totaling RM4.0b with coupons between 3.69-4.81% and BGSM's AA3 rated 5Y and 6Y bonds with a coupon of 4.47% and 4.56% respectively.

Outlook for September 2022

Expect volatility in USTs due to "tug-of-war" between elevated inflation and potential recessionary conditions…

The Federal Reserve will have its next FOMC meeting on **21st of September for which we see higher odds of another 75bps rate** hike. Some of the world's central bankers continued tightening monetary policy aggressively in September, with the latest being the ECB which raised its benchmark main refinancing rate by 75bps to 0.75% and also the RBA which raised the cash rate target by 50bps to 2.35%. Inflation is being turbo-charged by runaway energy prices, which have soared since Russia's invasion of Ukraine in February. Price rises are also being seen in areas including food, clothing, cars, houses, household appliances and services. Factors include ongoing supply chain issues and the knock-on effects of recent heat-waves have helped drive up prices. The implied volatility, denoted by the ICE BofA MOVE index has eased off from the highs seen during mid-August 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 its resolve to fight inflation rather than stress the importance on maintaining economic growth.

Nevertheless, the potential future US inflation post-August data releases may cap further rises in UST yields as the outlook for the policy rate may be more sedate going into the 4th quarter. The prominent yield curve inversion denoted by the 2s10s spread has cannot be ignored and will continue to be perceived as a reliable predictor of a potential recession ahead. The ongoing reduction in US Treasury 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 until end-September seems to be well-absorbed. Swaps traders now continue to price-in anticipated rate hikes of up to another ~150bps in arriving at an implied rate of ~3.86% levels as at end-2022. **Nevertheless, the yield curve may potentially shift slightly lower as aggressive rate hikes may abate slightly over potential cooling of US inflation data with focus on signs of economic slowdown following the technical recession seen in 1H2022.** The likelihood of a rate hike between 50-75bps in the upcoming FOMC meeting on 21st September is expected to be digested and have lesser 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 loss of 2.9% in August (July: +3.2 %); despite the sustenance in OAS spreads at ~ 140bps in August. Concerns over potential recessionary economic conditions in the future has eased and is expected to be kept at bay as confidence in the Fed's abilities to steer away from recessionary conditions continue to build-up. The Bloomberg Barclays US Corporate High Yield Total Return Index (for High Yield or HY) also reversed into a loss of 2.3% for August 2022 whilst spreads rose slightly by 17bps instead to 482bps. Expect issuance to come either side of $10b in September, as has been the case in the past several months with maturities in the region of $4b. Overall, US bond funds have seen $3b on inflows in August, a notable shift from the YTD average of $7b in monthly outflows. Nevertheless, banks have remained net sellers as their securities portfolios continue to decline.

The UST 10Y is expected to range slightly lower between 3.20-3.40% compared to our previous month forecast; finding support at key 3.40% levels for this month. We continue to maintain a neutral-to-slightly-positive view for nominal USTs with slight bias towards "steepeners" instead. as we opine that headline inflation may have peaked at the 8.5% handle despite the Fed's strong indication of maintaining its "fight against inflation" at the recent Jackson Hole symposium. We are not overwhelmingly favoring MBS which forms the backbone of the USD$9 trillion mortgage market, as the Fed's ongoing QT sees monthly balance sheet rundown of $20b. We also favor HY bonds that offer some value as a buffer against rising benchmark rates as investors are not pricing in a deep recession.

Local govvies may similarly see yields range sideways-to-lower on lower momentum and volumes…

The MYR bond market saw average BTC ratios for the three (3) auctions in August 2022 ease but nevertheless maintain above the 2.0x handle i.e., at 2.29x (July: 2.70x). The slightly higher-than-expected reopening of RM5.0b of 3Y GII 10/25 on 14th of Sep is expected to be well-absorbed by the well-diversified profile of mainly local and foreign inter-bank institutions with strong primary bond appetite. Volatilities were seen easing post 25bps OPR hike at the recent Malaysia BNM MPC meeting in September saw mainly local investors nibbling in the secondary market. The ongoing Russia-Ukraine war and the Fed's balance-sheet runoff is expected to have lesser impact than previously thought. Inflation is thought to reach its peak in 3Q2022 and is expected to taper-off towards the end of the year.

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 September month is expected to see lower net issuances of **RM3.5b compared to RM5.0b in August (projected gross issuances > maturities)**; resulting in the less pressure of shortfall in investments to boost liquidity in bonds. The wide and well-diversified base of investors together with 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 RM120.0b is lower than actual issuances of RM123.5b as at the time of writing, despite the view that govt issuances will be capped lower due to the ability of PETRONAS to contribute higher dividends in 2022.

We remain cautiously optimistic that the Malaysian economy would continue to see further acceleration in economic activities in 2H2022 as we expect growth to pick up further to double-digit pace in 3Q before normalizing in 4Q. **We therefore see the case of a rate pause in November with the OPR ending at 2.50% for the year as any further policy return to pre-pandemic levels will depend on the sustainability of current growth momentum and inflation trajectory.**

The Sukuk/Corporate Bond space will continue to see stronger demand as yield pick-up is favored as credit remains steadfast in the current strong economic climate. We expect the 10Y MGS yield to maintain its similar trading range between 3.90-4.10% as per our previous month forecast, with support pegged at 4.10% levels. The 5-10Y and 15Y sectors for both MGS/GII currently reflect some value proposition along the curve. In the corporate bonds/Sukuk space, we still favor local bonds tied to power generation, selective highway operators, transportation, logistics that include port operators and utilities sector such as electricity, telecommunications and sewerage. Our preferred tenures include 15Y GG (20bp spread), 7-10Y AAA (47-48bps spread) and 7-10Y AA2 (76-79bps).

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