Monthly Fixed Income Perspective –

September 22 review & October 22 outlook

US Bond Market

- **In September**, US Treasuries (UST) had a “torrid” month as the Fed’s hawkish rhetoric was translated into actual action with the FOMC raising the Fed Funds Rate further by another 75bps to between 3.00-3.25% at its September FOMC meeting. This was due to continued fears of inflationary pressures as September CPI data revealed sticky inflation especially in core CPI at +0.6% m/m and +6.3% y/y (headline inflation remained elevated at 8.3%). The jobs market was still strong despite notching lower numbers in the past three consecutive months. The curve bear-flattened as benchmark UST yields spiked 49-84bps, led mainly by the front and intermediates. **The 2Y UST yield ended 84bps higher at 4.28% whilst the 10Y moved 73bps to 3.83%.** At the time of writing, these yields have however moved higher to 4.47% and 3.95% levels with the 2s10part of the yield curve remaining inverted.

- **For October**, expect UST shorter-ends to remain elevated following the Fed’s aggressive policy-tightening stance due to persistent inflation and still strong labor market; despite the smallest gain in almost 17 months. The sticky core CPI is expected to push the curve flatter. A key gauge of investors’ inflation expectations, i.e.; the 5Y breakeven inflation rate is currently hovering at 2.55%, higher than the 2.20% lows seen in September but off-the-high of 2.85% seen in late-August. Nevertheless, the rate is still some way-off from the rate of 2.00% that the Fed is keen to anchor its policy at. **The UST 10Y is expected to range higher between 3.90-4.10% compared to our previous month forecast; finding support at key 4.10% levels for this month.** We continue to maintain a neutral view for nominal UST tenures as concerns arise over tapering of liquidity. We also favor IG credits that come with strong balance sheets with mid-duration i.e.; 5-10Y especially in capital goods, energy and financials.

MYR Bond Market

- **In September**, MYR government bonds were sold-off with some correlation to UST movements. The curve shifted sharply higher as overall benchmark yields jumped 30-44bps higher across. **The benchmark 5Y MGS 11/27 yield rose 30bps to 4.04%, whilst the 10Y MGS 7/32 settled 44bps higher at 4.41%. Total MYR Government bonds (MGS+GII+SPK) holdings saw overall outflows of RM2.5b to RM226.2b (representing 22.9% of total outstanding).** The primary factors which drove bond movements were still foreign-led; as the continuation of the Fed’s hawkish rhetoric via several FedSpeak events and the proposed UK fiscal plan caused a global bond rout. Elsewhere, the three (3) auctions in September 2022 saw average BTC ratios drop below the 2.0x handle i.e., at 1.95x (Aug: 2.29x).

- **For October,** expect concerns to linger over the potential increase in govvies issuances next year following the unveiling of National Budget 2023 and the dissolution of parliament to pave the way for GE15 in early-November. The inflation narrative in the US and weaker MYR may initially dampen hopes of bond recovery but support for bonds is expected by well-diversified investment institutions. We expect a double-digit advance in 3Q2022 GDP growth, before tapering-off to low single-digit in 4Q2023, maintaining our full-year growth projection of 7.4%. On the flip-side however, emerging values coupled with the weaker MYR may prompt bond interest by foreign portfolio investors. **The Sukuk/Corporate Bond space may yet see demand as yield pick-up turns attractive whilst credit quality remains steady in the current strong economic climate. We expect the 10Y MGS yield to maintain its higher trading range between 4.30-4.50% with support pegged at 4.50% levels**. The 5-10Y MGS and 15Y GII sectors currently reflect relative value from term-premium perspective. In the corporate bonds/Sukuk space we favor the 5-7Y AAA (35-51bps) and 20Y AA (55-85bps) AAA-rated bonds, within sectors comprising utilities, logistics, power/energy, highway/toll sectors.

MYR sovereign curve (MGS)

Source: Bloomberg

NFP pulled back in September but nevertheless indicated resilient job market strength; putting on further pressure on interest rate rise of up to 75bps in November…

Despite lower numbers, September Non-Farm Payrolls ("NFP") beat consensus estimates of 255k by notching a monthly gain of 263k. This was lower than preceding month's revised numbers of +315k. The job gains were notably strong especially in leisure, hospitality, healthcare, and professional services. The retail sector, on the flip-side, shed more than1,000 jobs for the month although remaining strong after three (3) months of gains. Meanwhile, the unemployment rate reversed to the 50-year low of 3.5% in September from 3.7% in the prior month; reflecting healthy labor market despite earlier back-to-back quarterly GDP contraction. The participation rate, however eased a tad lower to 62.3% from prior month's 62.4%. The average m/m hourly earnings, a gauge of wage inflation and a key metric tracked by the Fed maintained a growth of 0.3% m/m in September with the y/y increase easing to 5.0% (lower than 5.2% in August); which is expected to be common in a mid-cycle economy. The tightness in labor market and current high inflation scenario may continue to grab the limelight instead of fears over economic contraction.

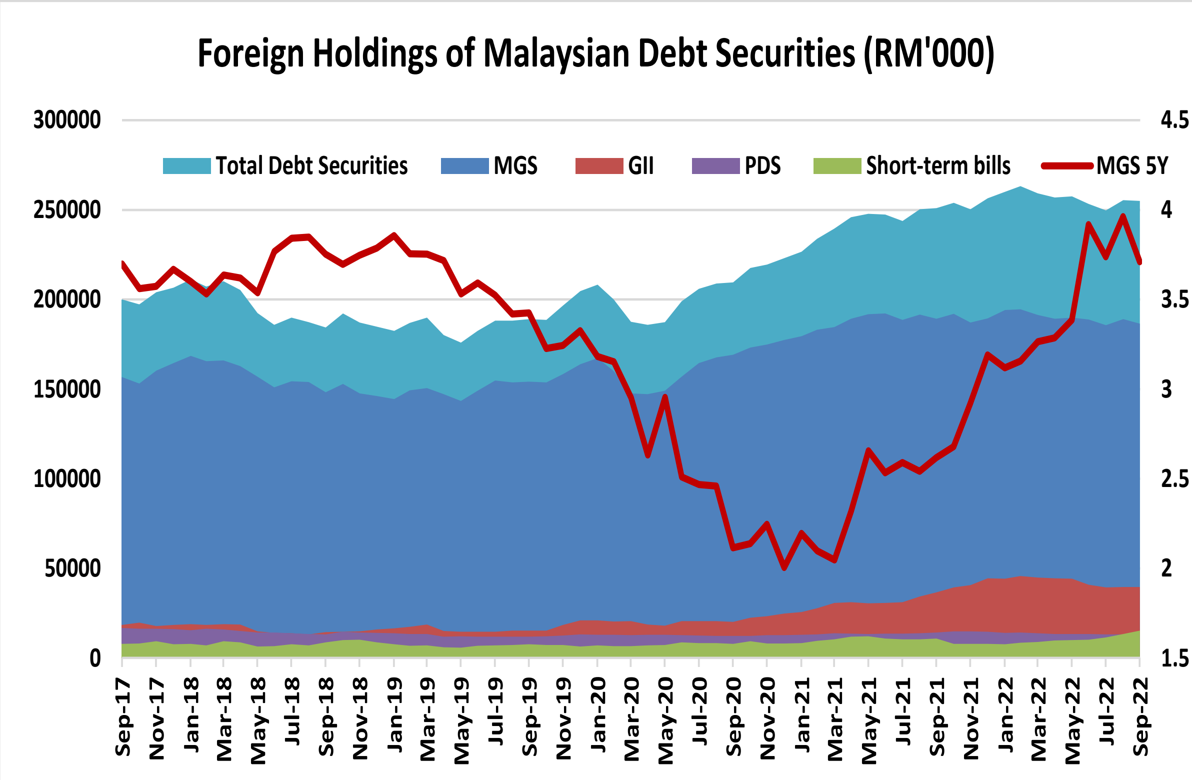
Moving on to other economic data, despite potential stalling in the manufacturing PMI for August @ 52.0 (Aug: 51.8) and slight dip in ISM manufacturing dip to 50.9 from prior month's 52.8, both remain in expansionary mode above 50 handle and are expected to see supply matching up to elevated demand for goods that is experiencing some improvement in supply chain logistics shipments. The ISM's index of services employment advance to the highest level in six (6) months, suggesting companies are having greater optimism in hiring. Separately, the Fed's preferred inflation measure i.e., core PCE in July spiked glaringly to +0.6% m/m from prior month's rise of 0.1%, whereas the y/y figures, jumped higher to 4.9% (previous month 4.6%). With both the headline and core numbers showing no signs of easing in inflationary pressures, there may still see some room for yields to spike for both UST and corporate bonds.

The Fed lifted the Fed Fund Rates for the 5th time at its last FOMC by another substantial 75bps on 22th September (for the record there were four earlier hikes i.e.; consisting of 25bps rate hike on 17th March in 2022, 50bps hike on 5th May, 75bps on 16th June and another 75bps on 28th July). The Fed's dot plot pins median rates from 16 officials at average 4.375% by end of this year; rising through to 4.675% in 2023. Additional data from the Fed Fund Futures now reflect traders' hypothetical expectations of 97% for a 75bps rate hike (72% odds of a 100bps rate hike) instead in the next FOMC meeting on 3rd November whilst CME Fed Watch Tool targets an 86% probability instead of a 75bps rate hike). Elsewhere, we note that the Fed's ~\$8.83 trillion balance sheet as at 31st of August has eased further to \$8.76 trillion as at 12th October with the ongoing run-off slightly impacting the movement of yields.

Foreign holdings of overall MYR bonds saw mild easing of a mere RM440m or 0.2% in September amid weaker Ringgit…

Foreign holdings of overall MYR bonds inched lower by RM440m or 0.2% in September to RM254.9b. Non-resident holdings of MGS however fell by RM2.6b (prior month: +RM3.5b) or 1.4% to RM186.5b, whilst forming lower i.e., 35.9% of total outstanding. This was due to concerns that rising inflation especially in the US may have not reached its peak and that narrowing interest rate differentials and weak MYR was an impediment for investment despite attractive emerging values for MGS/GII. **Total MYR Government bonds (MGS+GII+SPK) holdings saw overall outflows of RM2.5b to RM226.2b (representing 22.9% of total outstanding) versus prior month's increase of RM3.6b;** despite net issuances of RM3.5b for the month (Aug: RM5.0b instead). Meantime, **12-month cumulative rolling inflows plunged to RM337m (prior month: +RM2.62b).** Foreign participation in both secondary market and auction exercises were muted amid the lower foreign holdings as investors stayed sidelined as EM bond yields surged higher against the backdrop of weak ASIA FX levels, including the MYR. Nevertheless, the well-diversified base and appetite of local investment Institutions namely GLIC's, pension funds, insurance companies and the likes of asset management companies is expected to provide decent support in the Fixed Income space.

Separately, equity inflows saw a reversal with outflows in September @ RM1.6b (Aug 2022: +RM2.0b) whilst the 12-month rolling inflows fell from RM9.52b from RM7.18b. On the currency side, the MYR weakened further against USD to 4.6375 as at end-September (end-Aug: 4.4760) and is currently trading above the 4.71 levels at the time of writing.



Source: BNM, HLBB Global Markets Research

BNM may raise OPR to 3.00% by a measured pace by 1Q2023…

BNM made its 3rd straight 25bps rate increase in the OPR to 2.50% on 8th September, as per our house projection. The decision was based on continued improvement in growth prospects of the Malaysian economy, which called for adjustment in the degree of monetary accommodation as it embarked on its normalization process. The domestic economy remained strong and is expected to continue expanding, underpinned by private sector spending as income and employment outlook remain positive. This is expected to 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. It also highlighted that the MPC is not on any pre-determined tightening path thereby offering hints of a potential pause reiterating that policy decisions will remain data dependent**.**

Given the continued expansionary National Budget 2023 which was unveiled recently, we opine that there is greater policy flexibility for further normalization in monetary policy to tackle inflation. Hence, we are expecting further OPR hikes at a measured pace of 25bps each, bringing the OPR to 3.00% by 1Q2023. The Ministry of Finance (MOF) expects the Malaysian economy to register a stronger recovery in 2022, in the range of 6.5-7.0% (base-point +6.5%). This marked an upward revision from the 5.5-6.5% levels first projected last October, and was above the 5.3-6.3% growth range projected by BNM back in March this year. **This latest forecast by MOF is a tad below our inhouse forecast of +7.4**% (2021: 3.7%).

Interest faded for new coupon offerings in September despite relatively low net issuances of RM3.5b…

The three (3) auctions in September 2022 saw average BTC ratios drop to @ 1.95x (Aug: 2.29x); below the 2.0x handle. The highest BTC of 2.383x among the three (3) auctions was notched by the new issuance of Sustainability Sukuk comprising of 15Y GII 3/38 which saw strong participation from institutions such as GLIC's, pension funds and insurance companies, resulting in a relatively short tail of 2.8bps. The other auctions consisted of the re-opening of 3Y GII 10/25 and the re-opening of 7Y MGS 4/29 which saw weaker covers of between 1.66-1.84x. Nevertheless, the three (3) auctions in September mentioned herewith saw higher individual sum of bids amounting to between RM8.3-10.7b. Since there were RM11.0b worth of maturities in September compared to actual issuances of RM14.5b, demand for auctions were muted as maturities may have not been ploughed back into the MYR government bond space due to aggressive rate hikes by the Fed coupled with FedSpeak rhetoric which overcame the potential accretive yield spreads. Our YTD projection of gross issuances of RM135.0b is slightly lower than the actual issuances of RM138.0b 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. We opine from the recent unveiling of National Budget 2023 that the continued elevated deficit would necessitate higher gross issuances of ~RM172b next 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	14/9/2022	4,500	5,000		123,500	1.836	3.450	3.474	3.483	66.4%
27	7-yr Reopening of MGS (Mat on 04/29)	7	Sep	Q3	22/9/2022	5,000	5,000		128,500	1.662	4.190	4.232	4.275	37.5%
28	15.5-yr New Issue of MGII (Mat on 03/38)	15	Sep	Q3	29/9/2022	5,000	4,500		133,000	2.383	4.600	4.662	4.690	80.3%
29	3-yr Reopening of MGS 03/25	3	Oct	Q4	6/10/2022	5,000	5,000		138,000	1.920	3.800	3.823	3.837	5.7%
30	10-yr Reopening of MGII (Mat on 10/32)	10	Oct	Q4	13/10/2022	5,000	3,500	2,500	144,000	1.739	4.480	4.506	4.533	16.7%
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	116,000	28,000	144,000	PROJECTED TOTAL ISSUANCE SIZE = 167,000,000				

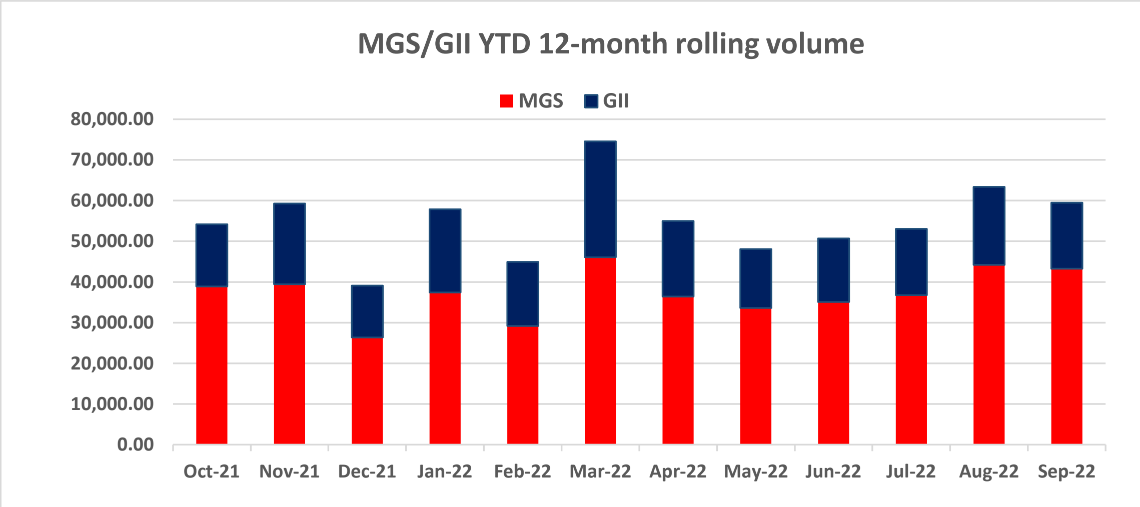
Source: BNM, HLBB Global Markets Research

MGS/GII secondary market activity managed to sustain in September…

Trading volume for MYR govvies i.e.; MGS + GII + SPK bonds surprisingly eased by a mere 1.1% m/m to RM65.1b in September compared to prior month's RM65.8b. Activity was decent despite the hawkish FedSpeak rhetoric amid September's 75bps rate hike took the limelight off potential fears over a possible economic slowdown as indicated by the reliable yield curve inversion. Major local events during the month included the unveiling of the National Budget 2023 which caused investors to mull the elevated budget deficit. Nevertheless, with the higher GDP base going forward as the economy improves post-COVID, the bright spark noted was the projected reduction in the fiscal deficit expected at 5.8% of GDP this year; to 5.5% in 2023. The dissolution of Parliament to pave way for GE15 initially saw bond yields impinged whilst equites pulled back. However, the former is expected to see some demand on safe haven bids. Strong secondary market activities were still led and supported mostly by local institutions that included pension funds, inter-bank participants, local GLIC's and real money investors that include Lifers. Some notable movements during the month under review were as follows:

- Both MGS/GII curves shifted higher in almost parallel fashion extending out from 3Y, with the largest deviation yield-wise seen in both 7Y-15Y sectors.
- MYR IRS levels jumped 29-37bps higher for 1-7Y tenures whereas tenures extending out from 10Y onwards spiked ~42bps.
- Bulk of the volume was seen in the short-ends such as MGS 3/23, 4/23, 8/23, off the-run 4/29 along with the recent re-issue of benchmark 5Y MGS 11/27.

Expect bouts of volatility to be largely influenced by both event risk (GE15) intertwined with safe-haven bids for bond asset class. We also expect MYR IRS movements corelated to interest rate outlook in both the US and in Malaysia to influence bond yield movements.



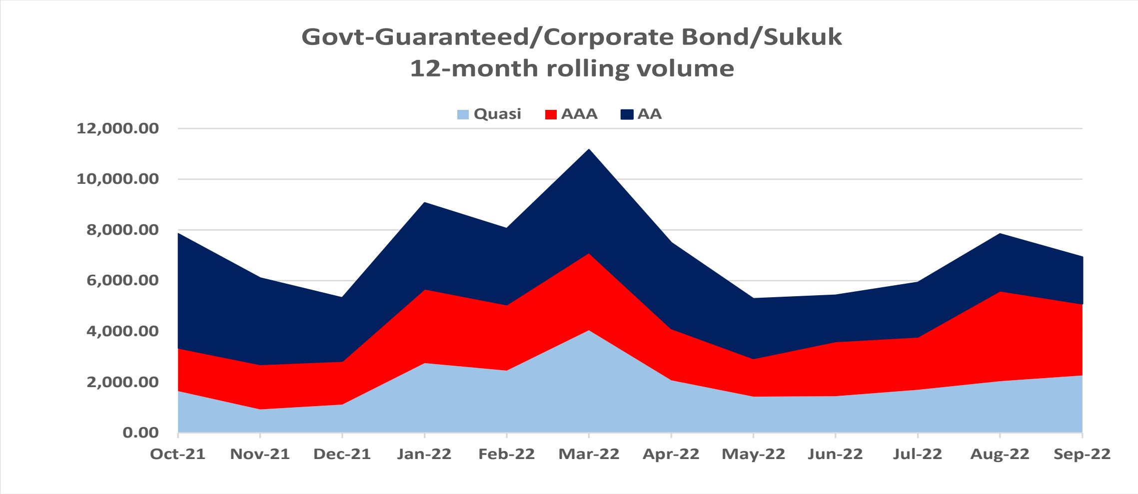
Source: BPAM, Bloomberg, HLBB Global Markets Research

Corporate Bonds/Sukuk saw lower secondary market appetite in September…

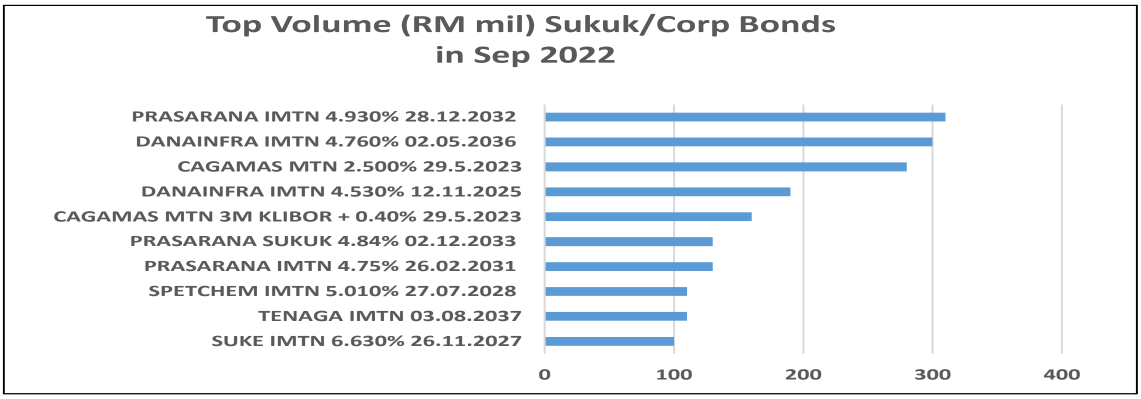
Overall Corporate Bonds/Sukuk (including Govt-Guaranteed bonds) also took cue from govvies and saw trading volume decrease by 7.7% in the secondary market to RM7.87b in September (Aug: RM8.53b). The muted appetite and momentum saw concerns over rising bond yields more of an impediment compared to attractive yield-carry requirements. Nevertheless, the higher primary issuances for the month saw decent take-up rates that may have also contributed to lesser participation interest in the secondary market. The Govt-Guaranteed (GG)-segment saw the 7-15Y tenures widening the most between 42-52bps to between 4.66-5.06%. The AAA-rated space similarly saw tenures between 7-15Y cheaper between 38-50bps; with levels around 4.81-5.30%. The AA2-segment saw yields settle higher between 37-41bps for 10-30Y tenures; resulting in yields closing within the ranges of 5.23-5.81% area. The sweet spot is now seen to be in the 7Y sector overall. Elsewhere, we note that foreign holdings for both GG and pure credits climb by RM141m to RM13.4b.

Total transactions for GG bonds in September jumped to form 32.7% (Aug: 25.9%) of overall volume. AAA-rated papers however saw total trades fall from 45.5% in August to form share of 40.8% of overall trades. The AA-space similarly saw its market share to ease slightly with secondary market trades at 26.5% share of overall investor interest (Aug: 28.6%). The GG-space was spread among names like DANAINFRA and PRASARANA. **Bonds that garnered top volume for the month were PRASA 6/47 (GG) which rose 7bps compared to previous-done levels to 4.35%, followed by BGSM 8/23 (GG) which spiked 31bps to 4.53%. Third was CAGAMAS 5/23 (AAA) which ballooned 115bps higher at 3.45%.**

Frequency and volume of bond trades in the credit space were mainly seen in CAGAMAS 23-25's, conglomerates (leg DRB-HICOM 22-29's and perps, MMC Corp 23-28's), Khazanah-related SPV's (i.e. DANUM 23-25's), toll-operator i.e. PLUS 24-37's, utilities provider i.e. telco/water/power (i.e. TELEKOM 23-28's, Air Selangor 29-42's, PASB 27-30's, TENAGA 29-47's and its related-companies like TNB Power generation 37's, TNB WE 23-28's, TNB NE 27's, 34's), TOYOTA Cap 23-26's, Sarawak Petchem 28-37's, QSPS Green 23-29's, PONSB 28-29's, EDRA 23-32's, BGSM 23-26's, SEB 26-29's, MAHB 25-30's, INFRACAP Resources 24's and 36's and UEM Sunrise 23-25's. The banking/finance sector saw frequent odd-lot denominated trades in AFFIN Bank 2032 callable bonds and perps, RHB Bank 2031, 2032 callable bonds, CIMB 2032 callable bonds, AISL 25 and 28's, MBSB 29-31's, GENM Cap bonds 27-28's, SABAH Development Bank 22-25's, UOB 2028, 2030 callable bonds, IJM perps, TG Excellence, PESTECH perps, YTL Power 27-28's, Eco World International 23's and Eco Capital 24's, YNH Property perps, Tropicana 23-27's and its perps.



Source: BPAM, Bloomberg, HLBB Global Markets Research



Source: BPAM, Bloomberg, HLBB Global Markets Research

Primary issuance prints in September driven by the following:

Notable issuances in Sep-22	Rating	Amount Issued (RM mil)
Prasarana Malaysia Berhad	GG	500
Pengurusan Air Selangor Sdn Berhad	AAA	400
Cagamas Berhad	AAA	660
IGB REIT Capital Sdn Berhad	AAA	1,200
edotco Malaysia Sdn Berhad	AA1	1,400
Sabah Development Bank Berhad	AA1	16
YTL Power International Berhad	AA1	225
CIMB Group Holdings Berhad	AA2	1,500
CIMB Bank Berhad	AA2	1,500
RHB Bank Berhad	AA2	500
VS Capital Management Sdn Berhad	AA2	500
Konsortium KAJV Sdn Bhd	AA3	120
Perbadanan Kemajuan Negeri Selangor	AA3	60
UEM Sunrise Berhad	AA3	295
BGRB Venture Sdn Berhad	NR	3
Cenviro Sdn Berhad	NR	28
Cypark Renewable Energy Sdn Berhad	NR	7
Hap Seng Management Sdn Berhad	NR	300
Magnum Corporation Sdn Berhad	NR	120
Naza TTDI Capital Berhad	NR	17
PNB Merdeka Ventures Sdn Berhad	NR	809
Perdana ParkCity Sdn Berhad	NR	30
Projek Smart Holdings Sdn Berhad	NR	15
Setia Fontaines Sdn Berhad (fka Setia Recreation Sdn Berhad)	NR	10
SunREIT Unrated Bond Berhad	NR	50
Tumpuan Azam Sdn Berhad	NR	15
Tanjung Pinang Development Sdn Berhad	NR	16
West Coast Expressway Sdn Berhad	NR	6
		10,302

Source: BPAM, Bloomberg, HLBB Global Markets Research

Fresh Corporate Bonds/Sukuk issuances in September fell by 12.6% from RM11.8b to RM10.3b. Some of the prominent issuances consisted of PRASARANA Bhd's govt-guaranteed 9-10Y bonds totaling RM500m with coupons ranging between 4.20-4.21% and edotco Malaysia Sdn Bhd's AA1-rated 3-10Y bonds totaling RM1.4b with coupons ranging between of 3.93% and 4.54% respectively.

Outlook for October 2022

Expect continued volatility in USTs on differing rate view dynamics by market participants…

The Federal Reserve will have its next FOMC meeting on **3rd of November for which we see a high probability of another 75bps rate hike**. Inflation is being impacted by higher input costs, strong demand and logistical constraints due to varying degrees of supply chain issues. The implied volatility, denoted by the ICE BofA MOVE index has spiked to the highs last seen in March 2020 period. The Fed's ongoing QT exercise via 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. Hence, it may not be expected to have a major impact. The US inflation landscape post-September data release however could cap further rises in UST yields as the outlook for the policy rate may be more sedate going into the 4th quarter as compared to the current initiatives to normalize policy and stem inflation amid a strong job market.

However, the prominent yield curve inversion (denoted by the 2s10s spread) may reignite concerns as a reliable predictor of a potential recession past 4Q2022 and cannot be ignored. Swaps traders now continue to price-in anticipated rate hikes of up to another ~135bps in arriving at an implied rate of ~4.49% levels as at end-2022. **Nevertheless, the yield curve could potentially shift slightly lower as pent-up views over aggressive rate hikes may ease as the impact of earlier rate hikes filter into the economy.** The rate hike of 75bps in the upcoming FOMC meeting may be a foregone conclusion and is expected to have been priced into USTs and eventually into 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 bigger loss of 5.3% in September (Aug: -2.9 %); despite the widening in OAS spreads to~ 164bps from 140bps in August. Concerns over deterioration in credit conditions remain foremost on investors' minds in view of elevated rates and the deep inversion in the yield curve. We project new issuance to be in the region of $25b in October. The Bloomberg Barclays US Corporate High Yield Total Return Index (for High Yield or HY) also went deeper into negative territory i.e.; with a 4.0% loss in September whilst spreads rose sharply by 33bps instead to 515bps. We expect issuance to be in the region of $4b in October, as has been the case in the past several months with maturities in the region of $6b. Overall, US bond funds have seen $18b of outflows in September, a notable shift from the YTD average of $7b in monthly outflows. Financial institutions, namely banks have remained net sellers for now.

The UST 10Y is expected to range higher between 3.90-4.10% compared to our previous month forecast; finding support at key 4.10% levels for this month. We continue to maintain a neutral view for nominal UST tenures as concerns arise over tapering of liquidity. We also favor IG credits that come with strong balance sheets with mid-duration i.e.; 5-10Y especially in capital goods, energy and financials. We also prefer to remain neutral on 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. Meantime, stronger balance sheets and higher yields allow us to favor IG credits which are better placed than equities to weather recessions. We see some value in the shorter maturities because of the safety provided; being closer to cash-like investments and attractive carry proposition. Persistent inflation also underpins our overweight on inflation-linked bonds.

Expect some volatility as emerging values coupled with the weak MYR is partially off-set by uncertainties ahead of GE15

The MYR bond market saw average BTC ratios for the three (3) auctions in September 2022 drop below the the 2.0x handle i.e., at 1.95x (Aug: 2.29x). The slightly lower-than-expected reopening of RM5.0b of 3Y MGS 3/25 on 6th of October and 10Y GII 10/32 was probably an indicator of sentiment for the remainder of the month. Volatilities are seen continuing post-25bps OPR hike at the recent Malaysia BNM MPC meeting in September. The ongoing Russia-Ukraine war and the Fed's balance-sheet runoff are expected to have been priced in for now. Inflation is thought to reach its peak soon 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 also believed to have been priced into the local govvies space. However, on the local scene, the net govvies issuances for October is expected to see spike in net issuances **(projected gross issuances > maturities)**; of **RM15.0b compared to RM3.5b in September** resulting in slightly increased pressure of shortfall in investments to boost liquidity in bonds. Nevertheless, expect support in both primary and secondary market to be forthcoming judging by the well-diversified profile and depth of local investment institutions whilst inter-bank participants maintain relatively active portfolios. This should augur well and is expected to provide a strong degree of support and stability for bond yields. The current run-rate of our estimated cumulative govvies issuances YTD @ RM140.0b is lower than actual issuances of RM144.0b as at the time of writing, in view of the potential ability of PETRONAS to contribute higher dividends in 2022.

Some concerns may linger over the dissolution of parliament to pave the way for GE15 along with potential increase in govvies issuances next year following the unveiling of National Budget 2023. On the macro front, the MOF expects the Malaysian economy to expand at a faster pace of 6.5-7.0% (point forecast 6.5%) this year, before tapering off to 4.0-5.0% (point forecast 4.2%) in 2023. We foresee upside to this year's forecast (ours +7.4%) while opine that the 2023 projection is realistic (ours +4.2%). **We believe there is greater policy flexibility for further normalization in monetary policy to tackle inflation. We therefore expect further OPR hikes, probably at a measured pace of 25bps each, bringing the OPR to 3.00% by 1Q2023.**

Nevertheless, the Sukuk/Corporate Bond space may yet see demand as yield pick-up turns attractive whilst credit quality remains steady in the current strong economic climate. We expect the 10Y MGS yield to maintain its higher trading range between 4.30-4.50% support pegged at 4.50% levels. The 5-10Y MGS and 15Y GII sectors currently reflect relative value from term-premium perspective. In the corporate bonds/Sukuk space, we favor the 5-7Y AAA (35-51bps) and 20Y AA (55-85bps) AAA-rated bonds, within sectors comprising utilities, logistics, power/energy and highway/toll sectors.

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