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Market volatility in February drives flight to safety

The latest edition of RAM Ratings' *Bond Market Monthly* highlights the shift in fund flows to safer-haven assets in February, as a result of concerns over US inflation risks, along with the anticipation of more aggressive US Federal Reserve (Fed) rate tightening following the first congressional testimony of the Fed's new chairman, Jerome Powell. Foreign holdings of Malaysian bonds experienced a net outflow of RM3.9 billion in February – a reversal from the prior three-month streak of inflows – amid the stalling appreciating momentum of the ringgit.

Meanwhile, corporate bond issuance moderated last month to RM6.9 billion from highs seen in 4Q 2017 (average: RM13.5 billion) and January (RM9.6 billion). The slowdown was attributable to the higher cost of financing – yields of 10-year AAA and AA1-rated papers were up six bps and four bps, respectively, m-o-m. Yields of longer-term Malaysian Government Securities (MGS) also surged, in line with rising global yields which reflect heightened inflationary expectations in the US and portfolio reallocation to safe-haven assets. Moreover, MGS papers on the short-end (one-year) saw a three bps m-o-m increase in February as investors repositioned funds in anticipation of the first Fed rate tightening in 2018 at the upcoming Federal Open Market Committee meeting to be held on March 21. However, upward pressure on MGS yields has eased in March, owing to the Monetary Policy Committee's decision to maintain the Overnight Policy Rate at its March meeting, and following recently announced US wage data which points to a gradual pace of rate hikes by US policy makers, hence reducing inflation fears.

With at least three rate hikes signalled by the Fed this year, and ongoing global developments such as worries about a global trade war triggered by more protectionist US trade policies, we may see some volatility in global foreign fund flows moving ahead. Additionally, investor sentiment could be affected by ongoing Brexit negotiations and upcoming elections in Russia (18 March 2018) and Malaysia (before August 2018), coupled with the inconclusive outcome of the recent Italian election.

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