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Media Release

Net foreign bond outflow of RM12.9 billion in May amid heightened uncertainty

Foreign holdings of Malaysian bonds were down RM12.9 billion in May on the back of increased market volatility, brought about by heightened domestic and foreign uncertainties. The value of foreign bond holdings declined to RM192.5 billion (-6.3% m-o-m) – the lowest level since August 2017. The share of foreign-held Malaysian Government Securities (MGS) to total outstanding MGS was reduced to 41.9% (April: 44.3%).

Comparatively, the market had seen a similar reaction during the taper tantrum in 2013 when the monthly net outflow reached a peak of RM13.0 billion (July 2013). The impact on the domestic bond market was greater shortly after the unexpected results of the US presidential election in November 2016 when foreign holdings fell by RM 19.9 billion. However, the latter had also coincided with BNM's clampdown on non-deliverable forwards, which had intensified selling pressure.

Market sentiment is significantly softer subsequent to the 14th Malaysian general election (GE14). The fiscal impact of the execution of the new government's election promises such as the reintroduction of a fuel subsidy, zero-rating of the GST and abolition of motorway tolls is a concern among market players as these moves could have an adverse effect on the country's sovereign credit ratings and currency. The ringgit has weakened to a monthly average of USD/RM3.98 so far in June from USD/RM3.89 during the pre-election period in April. Furthermore, renewed worries about national debt levels, the ongoing review of mega infrastructure projects and shifts in key management positions in several government-related entities and institutions, including Bank Negara Malaysia (BNM), have made market players more wary.

On the global front, external threats from trade wars, geopolitical tensions and further US Federal Reserve and European Central Bank liquidity tightening continue to fuel the current sell-off in emerging markets such as Malaysia. Foreign investment in short-term Malaysian bonds decreased by RM2.3 billion in May as investors priced-in for a US rate hike prior to the Federal Open Market Committee (FOMC) meeting in June, which saw rates increased by 25 bps, bringing the Federal Funds Rate to 1.75%-2.00%. The widely anticipated Fed hike was accompanied by forward guidance on two more rate increases this year on the back of better economic growth, unemployment

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and headline inflation expectations. This would take the total number of hikes for 2018 to four instead of the three indicated until the last FOMC meeting in March.

With a more steadfast tightening trajectory, increased upward pressure on domestic yields is expected as foreign holdings continue their decline. Malaysian bond yields across almost all rating bands and tenures had risen in May as a result of persistent selling. Rising bond yields, which translate into a higher cost of borrowings, could have also impeded issuances and may hold back debt issuances going forward. Corporate bonds recorded the lowest monthly issuance for the year in May at RM6.8 billion. This could also be due to issuers having withheld issuances ahead of GE14.

Moreover, about RM21.2 billion and RM14.5 billion of MGS/GII are expected to mature in 3Q 2018 and 4Q 2018, respectively, which could also instigate further outflows from the Malaysian bond market. "That said, market sentiment may improve as new government policies emerge, giving rise to greater confidence among market players and potentially relieving some outflow stress on the market," notes Kristina Fong, RAM's Head of Research.

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Date of release: 14 June 2018

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Published by RAM Rating Services Berhad