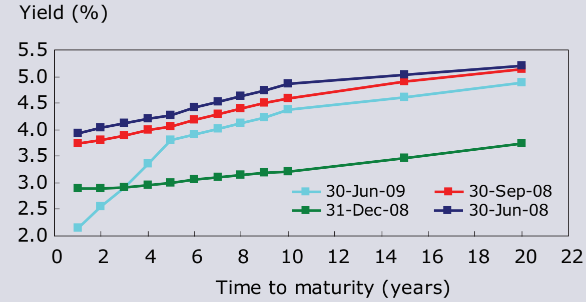
Malaysia—Update

Yield Movements

The Malaysian government has been pursuing an expansive fiscal policy since the beginning of the year. On 10 March it announced an MYR60 billion stimulus package, generating concerns that the supply of longer-maturity debt will balloon as the government raises funds to support the package. On 20 March, the government announced a revision of the existing 2009 auction calendar for Malaysian Government Securities (MGS) and Government Investment Issues (GII) by increasing the number of offerings from 27 to 28. The frequency of debt offerings was also changed as follows: 2-year from zero to two issues, 3-year from six to nine issues, 5-year from ten to eleven issues, 10-year from nine to six issues, and 20-year from two to zero issues. This announcement has had the effect of steepening the government bond yield curve.

Figure 1: Benchmark Yield Curve—Local Currency Government Bonds



Source: Bloomberg LP.

In June, Malaysian government bond yields fell at the short end of the curve, while yields at the middle to the long end rose, compared to December **(Figure 1)**. The sharp rise in yields at the long end of the curve was due to investors demanding a higher premium amid heightened risk at home and in Malaysia's major export markets. Bank Negara Malaysia (BNM) is optimistic about an economic recovery towards the end of the year and has maintained its overnight policy rate at 2.0% during its last 3 monetary policy meetings after initiating a series of rate cuts over the period of November 2008–February 2009.

BNM reported that its accumulated monetary policy initiatives and measures to enhance financing access, coupled with the government's additional stimulus package, adequately support domestic demand.

A slowing inflation rate also allowed room for maintaining the overnight policy rate at 2.0% for the April–June period. The consumer price index (CPI) fell to 3.9% year-on-year (y-o-y) in January from 4.4% in December; and consistently slowed in February, March, April, and May to 3.7%, 3.5%, 3.0%, and 2.4%, respectively. The CPI eventually fell to negative territory when it declined to –1.4% in June. The decline in consumer prices is mainly due to changes in the price of petrol and diesel that began in June 2008. The CPI for the January–June period increased by 2.5% y-o-y, resulting from increases in all major price indices except transport, clothing and footwear, and communication.

Size and Composition

Total local currency (LCY) bonds outstanding for Malaysia in the first half of 2009 stood at MYR610 billion, a decrease of 0.4% y-o-y, with outstanding government bonds falling by 5.5%. Outstanding BNM Bills and state-owned bonds (e.g., Khazanah and Cagamas bonds) fell by 54.3% and 59.0%, respectively **(Table 1)**. Outstanding central government bonds (e.g., Malaysian Treasury bills, Malaysian Islamic Treasury bills, GII, and MGS) held up as the public sector grew by 17.6% y-o-y.

Total LCY government bonds rose by 4.6% q-o-q during 2Q09 and central government bonds rose by 7.3% q-o-q as the government issued more bonds to fund its MYR60 billion stimulus program. However, outstanding BNM bills fell by 1.8% q-o-q and bonds of state-owned companies fell by 12.4% q-o-q.

Table 1: Size and Composition of Local Currency Bond Market

	Amount (billion)								Growth Rate (%)						
	Mar-09		Apr-09		May-09		Jun-09		Mar-09		Apr-09	May-09	Jun-09		
	MYR	USD	MYR	USD	MYR	USD	MYR	USD	y-o-y	q-o-q	m-o-m	m-o-m	y-o-y	q-o-q	m-o-m
Total	583	160	590	166	597	171	610	174	0.9	3.3	1.16	1.18	-0.4	4.6	2.2
Government	321	88	325	92	329	94	339	96	-6.4	4.5	1.24	1.23	-5.5	5.5	2.9
Central Government Bonds	268	74	270	76	278	80	288	82	14.5	5.6	0.6	3.1	17.6	7.3	3.4
Central Bank Bills	45	12	47	13	43	12	44	12	-51.1	5.0	6.1	-9.3	-54.3	-1.8	2.1
Others	8	2	8	2	8	2	7	2	-52.7	-23.3	-2.6	-1.3	-59.0	-12.4	-8.8
Corporate	262	72	265	75	268	77	271	77	11.6	1.9	1.07	1.12	6.8	3.5	1.3

y-o-y = year-on-year, q-o-q =quarter-on-quarter, m-o-m = month-on-month.
Note:
1. Calculated using data from national sources.
2. Bloomberg end-of-period LCY–USD rate is used.
3. Growth rates are calculated from LCY base and do not include currency effects.
4. Others refer to debt securities issued by both Cagamas Berhad and Khazanah Nasional Berhad.

Source: Bank Negara Malaysia, Fully Automated System for Issuing/Tendering (FAST), and Bloomberg LP.

LCY corporate bonds outstanding amounted to MYR271 billion at the end of June, an increase of 6.8% y-o-y. In 2Q09, outstanding corporate bonds grew only 3.5% q-o-q, although issuance rose by 92.0% q-o-q. The rise in issuance seems to reflect the government's new measures to improve access to capital markets—such as the exemption of mandatory credit rating requirements for convertible and exchangeable bonds and *sukuk* (Islamic bond) issue, which was implemented in March (see **Policy, Institutional and Regulatory Developments**)—while significant amortization and repayment of corporate bonds occurred in 2Q09.

Bloomberg data shows that at the end of June, the top 20 corporate issuers, which comprise more

Table 2: Top 20 Corporate Issuers (MYR billion)

Issuer	Amount Outstanding
1. Project Lebuhraya (Tollways Operator)	26.9
2. Berjaya Corp. (Conglomerate)	19.6
3. KL International Airport (Intl. Airport)	13.7
4. Tanjung Bin (Power Station)	10.2
5. Prasarana (Public Transport Operator)	10.2
6. Malayan Banking (Banking)	9.1
7. Putrajaya Holdings (Developer)	8.6
8. Tekad Mercu Bhd. (Special Purpose Finance Company)	8.0
9. Malakoff Corp. Bhd. (Independent Power Producer)	7.9
10. Jimah Energy (Power Sector)	7.3
11. Nucleus Avenue (Investment Company)	7.3
12. Tenaga Nasional (Electric Utility)	7.3
13. Telekom Malaysia (Telecommunication Co.)	6.0
14. Kapar Energy (Power Generation)	5.1
15. Midciti Res Bhd. (Residential Construction)	4.8
16. Bank Pembangunan (Gov't-owned DFI)	4.0
17. CIMB Bank Bhd. (Banking and Financial Srvcs.)	4.0
18. Encorp System (Conglomerate)	3.8
19. Silterra Capital (Semiconductor Foundry)	3.6
20. Berjaya Land (Developer)	3.6
Total	**171.1**
% of total corporate outstanding	**63.1%**

Source: Bloomberg LP.

than 60% of total corporate bonds outstanding **(Table 2)**, were mainly from the industrial and infrastructure sectors. Infrastructure development is the focus of the Ninth Malaysian Plan—Malaysia's economic development plan for 2006–2010. Project Leburaya, a tollway operator, was the largest issuer in terms of outstanding bonds.

Investor Profile

As of March 2009, financial institutions had overtaken social security institutions as the largest holders of MGS. Financial institutions hold 41% of outstanding MGS **(Figure 2)**, while social security institutions—including the Employees Provident Fund, which is required to invest 30% of its assets in MGS—hold 38% of outstanding MGS.

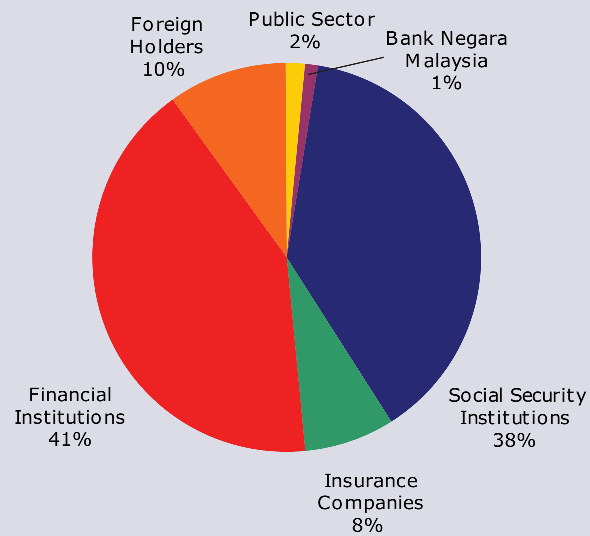
Foreign holders and insurance companies hold 10.0% and 8.0%, respectively, of total MGS outstanding. Foreign holdings of MGS fell slightly during 1Q09 after having grown significantly since 2005 **(Figure 3)**. During 2Q09, foreign holdings of MGS rose to levels attained at the end of 2008, amounting to MYR28.3 billion.

Turnover

Monthly data shows that government bond trading volumes rose to MYR58.1 billion in January and MYR67.7 billion in February after trading volumes declined in 4Q08 **(Figure 4)**. The turnover ratio was 0.18 in January and 0.21 in February. In March, the trading volume fell to MYR58.6 billion and the turnover ratio was 0.18 after a total of MYR10 billion of existing MGS benchmark papers was issued following the announcement of the government's second stimulus package.

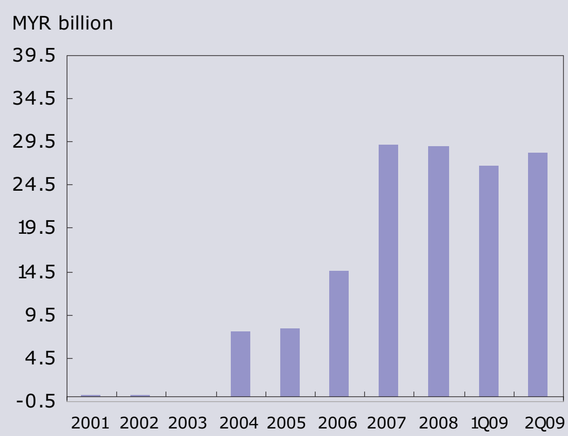
Government bond turnover varied in April and May amid speculation on whether BNM would slash its policy rate for a fourth straight time following a contraction of the economy in 1Q09. Trading volume for April and May was MYR71.3 billion and MYR60.7 billion, respectively, with a turnover ratio of 0.22 in April and 0.19 in May. Trading in June rose to MYR63 billion, boosted by debt auctions in MGS, with a turnover ratio of 0.19.

Figure 2: Local Currency Government Bonds Investor Profile (March 2009)



Source: Bank Negara Malaysia.

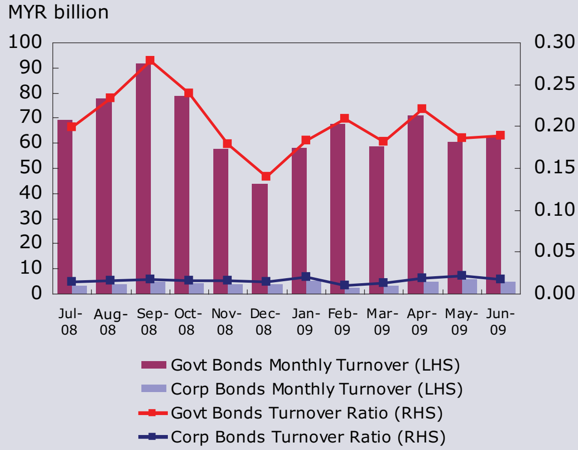
Figure 3: Amount of Foreign Holdings of Malaysian Government Securities



Source: Bank Negara Malaysia.

Monthly corporate bond turnover rose in January to MYR5.3 billion from MYR3.9 billion in December, driven by rising investor appetite for corporate bonds following a 75 basis point cut in the overnight policy rate. The turnover ratio in January was 0.02. In February, however, bond trading volume

Figure 4: Bond Trading Volume and Turnover Ratio



Source: Bank Negara Malaysia.

fell to MYR2.6 billion and the turnover ratio fell to 0.01 on heightened risk aversion amid a difficult operating environment for corporations. Trading volume recovered in March to MYR3.6 billion, with a turnover ratio of 0.014. Corporate turnover remained robust in subsequent months, reaching MYR4.9 billion and MYR5.8 billion in April and May, respectively, as the turnover ratio rose to 0.019 in April and 0.022 in May. This was followed by lower trading volume in June at MYR4.8 billion, as the turnover ratio fell to 0.018.

Rating Changes

On 9 June, Fitch Ratings lowered Malaysia's long-term LCY rating to A from A+ and revised its outlook to stable from negative. Fitch's rating action reflects the deterioration in Malaysia's public finance position when measured against its A-rated peer group. Meanwhile, Fitch affirmed the long-term foreign currency (FCY) outlook at A- and also affirmed its outlook of stable. Malaysia still has an FCY outlook of stable from all three major rating agencies.

Table 3: Long-term FCY Sov. Ratings

	Moody's	S&P	Fitch
Ratings	A3	A-	A-
Outlook	stable	stable	stable

Policy, Institutional, and Regulatory Developments

Malaysia launches second stimulus plan worth MYR60 billion

On 10 March, the Ministry of Finance announced a second stimulus plan worth MYR60 billion, which is several times larger than the MYR7 billion plan announced in November 2008, following the government's forecast of a contraction in the economy. The second stimulus plan would run over the next 2 years and swell the 2009 budget deficit to 7.6% of GDP. Finance Minister Najib Razak said that the additional spending would be funded from domestic sources. The MYR60 billion plan can be broken down into the following components:

(i) MYR15 billion—fiscal injection,
(ii) MYR25 billion—guarantee funds,
(iii) MYR10 billion—equity investments,
(iv) MYR7 billion—private finance initiative and off-budget projects, and
(v) MYR3 billion—tax incentives.

Malaysia Announces Measures to Liberalize Capital Markets

On 30 June, Prime Minister Datuk Seri Najib announced measures to further liberalize foreign investment and open up Malaysia's domestic capital markets. The measures are part of the country's shift to a new economic model, following liberalization in the financial sector and services sub-sectors. Some of the important measures announced include:

(i) ownership in the wholesale segment of the fund management industry will now be allowed up to 100% for qualified and leading fund management companies;
(ii) foreign shareholding limits for unit trust management and stock broking companies will be raised to 70% from 49%;

(iii) the Foreign Investment Committee guidelines on the acquisition of interests, mergers, and takeovers have been repealed; and,
(iv) the 30% *bumiputra* (ownership by ethnic Malays) requirement for initial public offering will no longer exist.

In addition, the Securities Commission will introduce a guideline requiring Malaysian companies seeking a listing to offer 50% of the public shareholding spread to *bumiputra* investors.

A new investment institution, Ekuiti Nasional Berhad (Ekuinas), will also be established. Ekuinas will serve as a private equity fund with initial capital of MYR500 million, which will subsequently be increased to MYR10 billion, focusing on investments in sectors with high-growth potential and joint investments with private sector funds.

Malaysia's Securities Commission release new measures to improve access to capital markets

After the Finance Ministry announced the second stimulus package, which specifies new measures to access the capital market, the Securities Commission (SC) on 16 March announced two measures to improve access to capital markets: (i) revisions to the terms and conditions of bonds and *sukuk* (Islamic bond), and (ii) exemption of the mandatory credit rating requirement for convertible and exchangeable bonds and *sukuk* issues.

The revision would save the issuer the cost of submission to the SC, which involves engagement of relevant advisers. On the other hand, the exemption of mandatory ratings aims to generate cost savings for issuers and reduce the time to market for new issues, since rating exercises normally take several weeks.

Malaysia Establishes National Financial Guarantee Institution to Support Corporations Raising Funds in Bond Market

To increase support for Malaysia's second economic stimulus package, the Malaysian government announced the establishment of the national financial guarantee institution, Danajamin Nasional Berhad (Danajamin), effective 15 May. Danajamin will provide financial guarantee insurance for issues of private debt and Islamic securities. The insurance will be available for securities issued by investment grade companies, which are defined as rated BBB or higher by a Malaysian rating agency. Danajamin will have the capacity to insure up to MYR15 billion of investment grade private debt and Islamic securities.