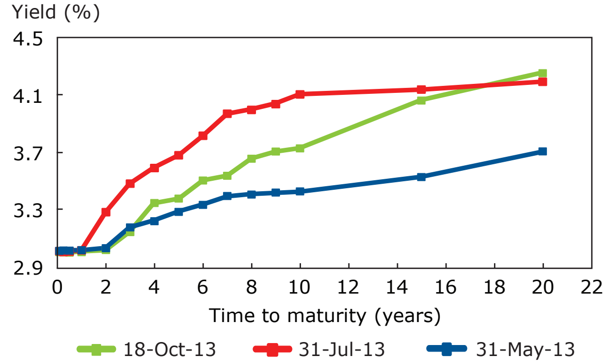
Malaysia

Yield Movements

Between end-May and end-July, Malaysia's local currency (LCY) government bond yields soared dramatically for tenors of 2 years and longer **(Figure 1)**. Yields for 10-year maturities surged the most, rising 68 basis points (bps), followed by 62 bps for 9-year maturities and 61 bps for 15-year maturities. The yield on government notes due March 2023 jumped to 4.1%, the highest for a benchmark 10-year bond since April 2011.

Figure 1: Malaysia's Benchmark Yield Curve—LCY Government Bonds



LCY = local currency.
Source: Bloomberg LP.

The yield curve had shifted downward by mid-October, as yields slumped for all maturities except the 20-year tenor. Yields for 7- to 10-year maturities dropped the most, falling between 33 bps and 43 bps. Yields for 20-year maturities, however, rose an additional 6 bps on the back of a 49 bps increase in July.

Bond yields have risen sharply since May on concerns stemming from the United States (US) Federal Reserve's announcement about tapering its monthly bond purchases. Domestic factors in Malaysia—including (i) a narrowing current account surplus and weakening ringgit, (ii) rising inflation expectations after the government cut fuel subsidies, and (iii) Fitch Ratings' credit outlook downgrade to negative—have dampened investor interest and clouded the demand outlook. However, speculation that the US government shutdown may delay tapering of the Federal Reserve's asset purchase program helped ease some concerns, with the yield on 10-year government bonds sliding to 3.7% in mid-October. Meanwhile, the yield spread between 2- and 10-year tenors narrowed to 71 bps in mid-October from 82 bps at end-July.

The ringgit weakened to a 3-year low of MYR3.3346–US$1 in August amid mounting concerns over the deterioration in the current account balance and the risk of capital outflows. In 2Q13, the current account surplus fell to MYR2.6 billion, shrinking from MYR8.7 billion in 1Q13 and MYR7.9 billion in 2Q12, mainly due to a smaller goods surplus. The current account surplus stood at 1% of gross domestic product (GDP) in 2Q13, down from 8% of GDP at the end of 2012. Meanwhile, the large redemption of sovereign debt also caused the depreciation in the ringgit on concerns that global investors will repatriate funds. At end-July, MYR9.2 billion (US$2.9 billion) of Malaysian Government Securities (MGSs) matured.

Consumer price inflation accelerated to 2.6% year-on-year (y-o-y) in September—the highest in 20 months—from 1.9% in August, led by higher food and transportation costs. The price index for food and non-alcoholic beverages inched up 3.9% y-o-y and transport prices rose 4.6%. On a month-on-month (m-o-m) basis, inflation increased 0.8%.

In its Monetary Policy Committee meeting on 5 September, Bank Negara Malaysia (BNM) decided to maintain the overnight policy rate at 3.0%, the same level where it has been since May 2011. BNM expects inflation to increase in the remainder of the year and into 2014 due to domestic cost factors, including subsidy adjustments. The increase in inflation, however, is from a low level and should be dampened by a stable external price environment, expansion in domestic capacity, and moderate domestic demand pressures.

Size and Composition

Total LCY bonds outstanding in Malaysia grew 1.8% quarter-on-quarter (q-o-q) and 4.1% y-o-y to reach MYR1.01 trillion (US$310.4 billion) at the end of 3Q13. Growth in the corporate bond market outpaced growth in the government bond sector, rising 3.8% q-o-q and 9.1% y-o-y **(Table 1)**.

Government Bonds. LCY government bonds outstanding stood at MYR590.2 billion at end-September, growing at modest rates of 0.5% q-o-q and 0.7% y-o-y. Central government bonds increased 1.9% q-o-q and 10.1% y-o-y, driven by growth in Government Investment Issues (GIIs) and MGSs. *Sukuk Perumahan Kerajaan* (Islamic bonds) also expanded rapidly from a low base, posting growth of 149.7% q-o-q and 495.4% y-o-y. However, BNM monetary notes continued to act as a drag on government bond growth, contracting 12.5% q-o-q and 32.6% y-o-y.

The share between conventional bonds and *sukuk* was comparable to that of the previous quarter, with conventional bonds accounting for 63% and *sukuk* comprising 37% of total bonds outstanding.

Government bond issuance fell 15.7% q-o-q to MYR85.2 billion in 3Q13, continuing a downward trend in place since 4Q12. Issuance volumes for central bank bills dropped almost 30% q-o-q and 52% y-o-y. Of the total issuance, *sukuk* comprised 57% and conventional bonds accounted for 43%.

In August, the government bond market saw the debut of the inaugural 20-year GII with an issuance size of MYR2.5 billion. Demand for the *shari'a*-compliant debt exceeded the offered amount by 1.6 times with an average yield of 4.582%. In September, Malaysia raised MYR2.5 billion from issuing a 30-year MGS, the longest-ever maturity on offer in Malaysia. The bond maturing in September 2043 attracted a bid-to-cover ratio of 2.4 times and was priced to yield 4.935%.

Corporate Bonds. Malaysia's LCY corporate bonds outstanding reached MYR421.4 billion at end-September, rising 3.8% on a q-o-q basis and 9.1% y-o-y. The share between *sukuk* and conventional bonds remained constant, with *sukuk* accounting for 67% of the total and conventional bonds comprising 33%.

Corporate issuance climbed 2.2% q-o-q to MYR21.1 billion in 3Q13, reversing the decline posted in the previous quarter. A total of 84 bond series were issued by 53 corporate entities, with conventional bonds accounting for 55% of new corporate bond issues and *sukuk* registering 45%. **Table 2** lists some notable corporate bonds issued during 3Q13.

Table 1: Size and Composition of the LCY Bond Market in Malaysia

	Outstanding Amount (billion)						**Growth Rate** (%)			
	3Q12		**2Q13**		**3Q13**		**3Q12**		**3Q13**	
	MYR	**US$**	**MYR**	**US$**	**MYR**	**US$**	**q-o-q**	**y-o-y**	**q-o-q**	**y-o-y**
Total	**972**	**318**	**994**	**314**	**1,012**	**310**	**4.1**	**15.7**	**1.8**	**4.1**
Government	586	192	588	186	590	181	4.8	16.1	0.5	0.7
Central Government Bonds and Bills	424	139	459	145	468	143	1.8	12.6	1.9	10.1
Central Bank Bills	159	52	123	39	107	33	12.0	24.5	(12.5)	(32.6)
Sukuk Perumahan Kerajaan	3	1	6	2	15	5	–	465.2	149.7	495.4
Corporate	386	126	406	128	421	129	2.9	15.3	3.8	9.1

( ) = negative, – = not applicable, q-o-q = quarter-on-quarter, y-o-y = year-on-year.
Notes:
1. Calculated using data from national sources.
2. Bloomberg LP end-of-period LCY–US$ rate is used.
3. Growth rates are calculated from LCY base and do not include currency effects.
Sources: Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) and Bloomberg LP.

Table 2: Notable LCY Corporate Bond Issuance in 3Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Kapar Energy Ventures		
1-year Islamic MTN	3.82	150
2-year Islamic MTN	3.97	180
3-year Islamic MTN	4.12	180
4-year Islamic MTN	4.22	200
5-year Islamic MTN	4.30	200
6-year Islamic MTN	4.39	200
7-year Islamic MTN	4.47	100
8-year Islamic MTN	4.55	100
9-year Islamic MTN	4.63	110
10-year Islamic MTN	4.71	110
11-year Islamic MTN	4.79	150
12-year Islamic MTN	4.87	160
13-year Islamic MTN	4.95	160
Cagamas		
3-month Islamic commercial paper	3.20	500
3-year Islamic MTN	KLIBOR+0.14	50
3-year Islamic MTN	KLIBOR+0.15	180
3-year MTN	KLIBOR+0.15	180
1-year MTN	3.40	160
2-year MTN	3.60	60
3-year MTN	3.75	15
Syarikat Prasarana Negara		
10-year Islamic MTN	4.26	500
15-year Islamic MTN	4.58	500
Public Bank		
10-year Subordinated MTN	4.80	1,000

LCY = local currency, MTN = medium-term note.
Source: Bank Negara Malaysia Bond Info Hub.

The largest corporate LCY issuer in 3Q13 was Kapar Energy Ventures (KEV), with issuance of Islamic medium-term notes (IMTNs) totaling MYR2 billion. KEV is a subsidiary of Tenaga Nasional, which was established to acquire and operate the Kapar Power Station, the largest thermal power station in Malaysia with a capacity of 2,420 megawatts. The proceeds from the issuance in July will be utilized to refinance the company's existing Bai' Bithaman Ajil Islamic Debt Securities facility, which is due to fully mature by 2019. The bond was rated AA+IS by Malaysian Rating Corp. Berhad (MARC) and given a stable outlook.

State-owned companies such as Cagamas and Prasarana were the next largest issuers in 3Q13, with issuances of MYR1.2 billion and MYR1 billion, respectively. In August, national mortgage corporation Cagamas issued three tranches of floating-rate bonds with 3-year tenors worth a total of MYR410 million. The bonds were rated AAA by both RAM Ratings and MARC and are based on a 15-bps spread on the 1-year Kuala Lumpur Interbank Offered Rate (KLIBOR). Meanwhile, public transport provider Prasarana issued a total of MYR1 billion of 10- and 15-year *sukuk* with profit rates of 4.26% and 4.58%, respectively.

Public Bank issued the single-largest note in 3Q13 amounting to MYR1 billion. The subordinated MTN is the first tranche of Public Bank's MYR10 billion bond issue under its Basel III-compliant Tier 2 program. The bond has a tenor of 10-years (5-year non-callable) and carries a coupon of 4.8%. It was rated AA1 with a stable outlook by RAM Ratings.

At end-September, the amount of LCY bonds outstanding of the top 30 corporate bond issuers in Malaysia stood at MYR225.2 billion and accounted for 53.4% of the LCY corporate bond market **(Table 3)**. Project Lebuhraya remained the largest issuer of LCY corporate bonds with MYR30.6 billion outstanding, followed by Cagamas and Khazanah Nasional, with outstanding amounts of MYR19.2 billion and MYR18.7 billion, respectively.

Investor Profile

Social security institutions were the largest holders of MGSs and GIIs in 3Q13, with 31.7% of total government bonds outstanding at end-June **(Figure 2)**, which was up slightly from 31.6% a year earlier but lower from 31.9% at end-March. In absolute terms, the holdings of social security institutions amounted to MYR144.1 billion at end-June, up from MYR130.3 billion a year earlier.

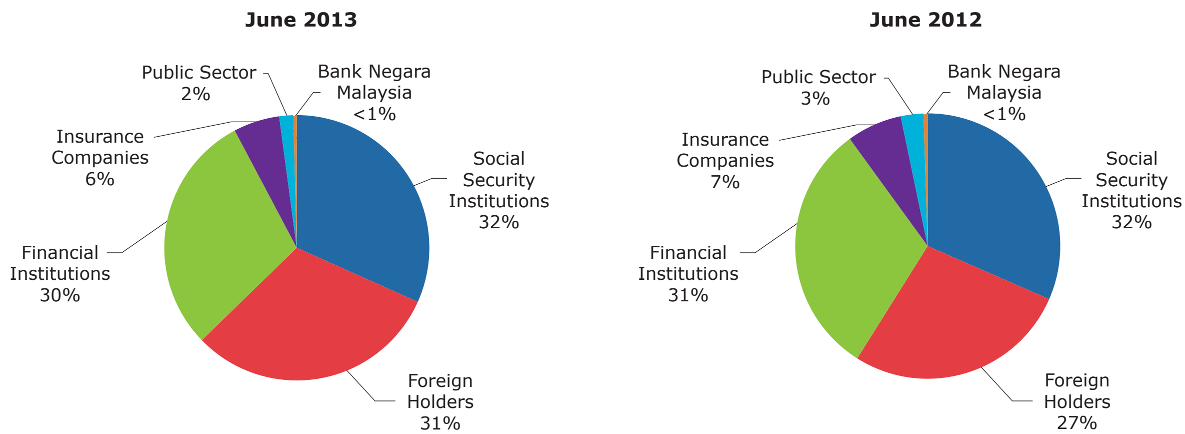
The share of foreign holdings climbed to 31% at end-June from 27.3% a year earlier and dropped slightly from 31.6% at the end of the previous

Table 3: Top 30 Issuers of LCY Corporate Bonds in Malaysia

Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
	LCY Bonds (MYR billion)	LCY Bonds (US$ billion)			
1. Project Lebuhraya Usahasama Bhd.	30.60	9.39	No	Yes	Toll Roads and Expressway
2. Cagamas	19.19	5.89	Yes	No	Finance
3. Khazanah	18.70	5.74	Yes	No	Quasi-Govt.
4. Pengurusan Air Bhd.	11.63	3.57	Yes	No	Energy, Gas, and Water
5. Prasarana	10.91	3.35	Yes	No	Transport, Storage, and Communications
6. Binariang GSM	9.89	3.03	No	No	Transport, Storage, and Communications
7. Maybank	9.70	2.98	No	Yes	Finance
8. CIMB Bank	7.75	2.38	No	No	Finance
9. Public Bank	6.07	1.86	Yes	No	Finance
10. Cagamas MBS	6.03	1.85	Yes	No	Finance
11. Perbadanan Tabung Pendidikan Tinggi Nasional	6.00	1.84	Yes	No	Quasi-Govt.
12. Senai Desaru Expressway	5.57	1.71	No	No	Construction
13. Sarawak Energy	5.50	1.69	Yes	No	Energy, Gas, and Water
14. Turus Pesawat Sdn. Bhd.	5.31	1.63	Yes	No	Quasi-Govt.
15. Putrajaya Holdings	5.26	1.61	No	No	Property and Real Estate
16. Malakoff Power	5.10	1.56	No	No	Energy, Gas, and Water
17. Aman Sukuk	5.03	1.54	Yes	No	Construction
18. Celcom Transmission	5.00	1.53	No	No	Transport, Storage, and Communications
19. 1Malaysia Development	5.00	1.53	Yes	No	Quasi-Govt.
20. KL International Airport	4.86	1.49	Yes	No	Transport, Storage, and Communications
21. Hong Leong Bank	4.86	1.49	No	Yes	Finance
22. Manjung Island Energy	4.85	1.49	No	No	Energy, Gas, and Water
23. AM Bank	4.61	1.41	No	No	Finance
24. RHB Bank	4.60	1.41	No	No	Finance
25. YTL Power International	4.12	1.26	No	Yes	Energy, Gas, and Water
26. Tanjung Bin Power	4.05	1.24	No	No	Energy, Gas, and Water
27. Jimah Energy Ventures	4.03	1.24	No	No	Energy, Gas, and Water
28. Danainfra Nasional	3.90	1.20	Yes	No	Finance
29. Danga Capital	3.60	1.10	No	No	Finance
30. Cekap Mentari	3.50	1.07	Yes	No	Finance
Total Top 30 LCY Corporate Issuers	**225.21**	**69.09**			
Total LCY Corporate Bonds	**421.39**	**129.28**			
Top 30 as % of Total LCY Corporate Bonds	**53.4%**	**53.4%**			

LCY = local currency.
Notes:
1. Data as of end-September 2013.
2. State-owned firms are defined as those in which the government has more than a 50% ownership stake.
Source: *AsianBondsOnline* calculations based on Bank Negara Malaysia Fully Automated System for Issuing/Tendering (FAST) data.

Figure 2: LCY Government Bonds Investor Profile

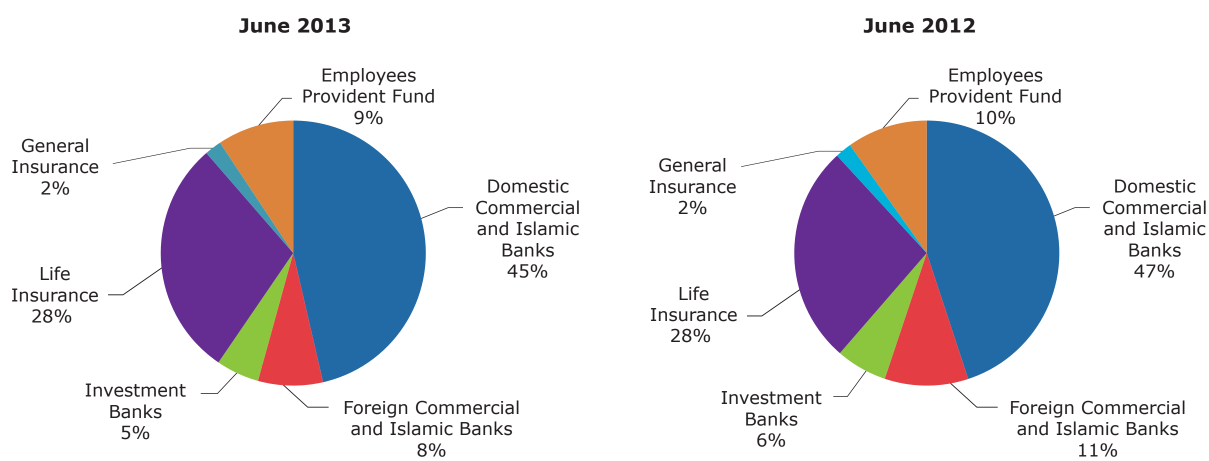


LCY = local currency.
Source: Bank Negara Malaysia.

quarter. Meanwhile, the holdings of financial institutions and insurance companies fell to 29.6% and 5.6%, respectively, at end-June from 31.1% and 6.7% a year earlier.

Domestic and foreign banks (commercial and Islamic) scaled back their shares of holdings in Malaysia's corporate bond market to 45.1% and 7.7%, respectively, at end-June from 46.6% and 10.6% a year earlier **(Figure 3)**. Meanwhile, investment banks also trimmed their position to 5.1% of total corporate bonds from 6.5%. Insurance companies slightly increased their share of corporate bond holdings to 30.5% at end-June from 29.8% a year earlier, continuing a trend in place since 2006.

Figure 3: LCY Corporate Bonds Investor Profile



LCY = local currency.
Note: Employees Provident Fund as of end-2012.
Source: Bank Negara Malaysia.

Policy, Institutional, and Regulatory Developments

Malaysia, Singapore, and Thailand Sign MOU to Establish ASEAN CIS Framework

On 1 October, the Securities Commission Malaysia, Monetary Authority of Singapore (MAS), and Securities and Exchange Commission of Thailand signed a memorandum of understanding to establish the framework for an ASEAN Collective Investment Scheme (CIS) that will facilitate cross-border offerings to retail investors in Malaysia, Singapore, and Thailand. The signatories expect the framework to be implemented in the first half of 2014.

BNM and the Central Bank of the United Arab Emirates Enhance Cooperation

On 10 October, BNM signed a memorandum of understanding with the Central Bank of the United Arab Emirates to further strengthen Islamic financial services linkages between the two countries.

2014 Federal Budget Released

On 25 October, Malaysia announced the release of its 2014 federal budget covering economic activity; fiscal management; and human capital, urban, and rural development. The government's fiscal deficit will be reduced from 4.0% of GDP in 2013 to 3.5% in 2014 as Malaysia moves toward a balanced budget by 2020. The government assured the public that the federal debt level will not exceed the government's limit of 55% of GDP. Malaysia will implement a series of fiscal consolidation measures including a 6% goods and sales tax (GST) by 1 April 2015, the abolition of the sugar subsidy of MYR0.34 per kilogram effective 26 October, and an increase in the real property gains tax (RPGT) rates. The government forecasts the domestic economy will grow 5.0%–5.5% in 2014, from an estimated 4.5%–5.0% growth rate in 2013, driven by annual growth in private investment of 12.7% and private consumption of 6.2%. Finally, to strengthen financial markets, the Securities Commission will introduce a Framework of Socially Responsible *Sukuk* Instruments that will support the financing of sustainable and responsible investments.