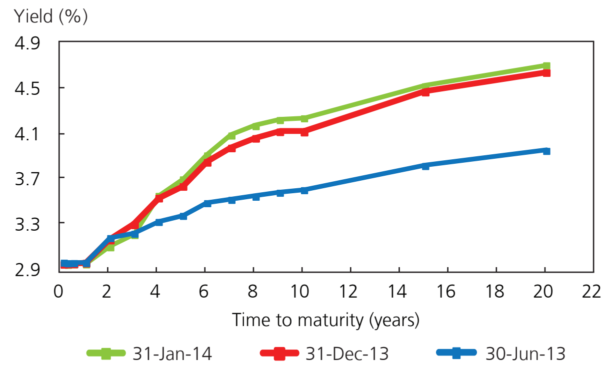
Malaysia

Yield Movements

Malaysia's local currency (LCY) government bond yield curve shifted upward between end-June and end-December 2013, with the yields of 3-year maturities and longer rising—as much as 67 basis points (bps) to 4.64% in the case of the 20-year maturity **(Figure 1)**. The higher yields for Malaysian Government Securities (MGS) benchmark paper tracked the sluggish performance of United States (US) Treasuries as market players were increasingly concerned that the US Federal Reserve would begin tapering its monthly bond purchases. Between end-December and end-January, yields were mixed, as tenors of 3 years and less declined, while yields from the 4-year maturity through the end of the curve showed an upward bias, with increases of between 2 bps and 12 bps. Meanwhile, the yield spread between 2- and 10-year maturities widened to 110 bps at end-January from a spread of 92 bps at end-December.

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



LCY = local currency.
Source: Bloomberg LP.

The Malaysian economy improved in recent months, aided by recovery in exports and resilient domestic demand. Real gross domestic product (GDP) growth inched up to 5.1% year-on-year (y-o-y) in 4Q13 from 5.0% in 3Q13. The fourth quarter y-o-y growth rate was the highest in 2013. On the demand side, all five types of expenditure registered positive y-o-y growth in 4Q13: private final consumption expenditure (7.3%), government final consumption expenditure (5.1%), gross fixed capital formation (5.8%), exports of goods and services (2.9%), and imports of goods and services (4.4%). On the production side, except for the mining and quarrying sector, which recorded a 1.5% y-o-y drop in output, all sectors posted positive y-o-y growth: agriculture (0.2%), construction (9.7%), manufacturing (5.1%), and services (6.4%). Also, import duties climbed 3.6% y-o-y. Annual real GDP growth, however, slipped to 4.7% in 2013 from 5.6% in 2012.

Foreign reserves rose by MYR14.5 billion in 2013 to MYR441.7 billion (US$134.9 billion), stemming from a continued surplus in the current account and inflows of foreign direct investment, non-resident portfolio funds, and banking funds. The current account surplus in 4Q13 amounted to MYR16.2 billion, larger than the 3Q13 surplus of MYR9.8 billion due to the merchandise trade surplus, which widened to MYR33.6 billion in 4Q13 from MYR25.8 billion in the previous quarter. In addition, between 3Q13 and 4Q13, the services account's deficit position narrowed from MYR4.3 billion to MYR3.7 billion, the deficit in the primary income account climbed from MYR8.1 billion to MYR9.9 billion, and the deficit in the secondary income account inched up from MYR3.5 billion to MYR3.7 billion. The current account surplus for the full-year 2013 stood at MYR37.3 billion, down from 2012's surplus of MYR57.3 billion.

Consumer price inflation quickened to 3.2% y-o-y in December from 2.9% in the previous month and 1.2% a year earlier due to higher prices for food and transportation. The y-o-y increase in consumer prices exceeded the benchmark overnight policy rate for the first time since November 2011 and was the highest in 2 years. Annual inflation climbed to 2.1% in 2013. On a month-on-month (m-o-m) basis, the consumer price index increased 0.3%.

At its Monetary Policy Committee meeting on 29 January, Bank Negara Malaysia (BNM) decided to maintain its overnight policy rate at 3.0%, which is the same level it has been set at since May 2011. BNM expects inflation to increase largely due to domestic cost factors. The increase in inflation, however, is expected to be tempered by a stable external price environment and moderate domestic demand pressures.

Size and Composition

Total LCY bonds outstanding in Malaysia grew 2.9% quarter-on-quarter (q-o-q) and 2.2% y-o-y to

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

	Outstanding Amount (billion)						**Growth Rate** (%)			
	4Q12		**3Q13**		**4Q13**		**4Q12**		**4Q13**	
	MYR	**US$**	**MYR**	**US$**	**MYR**	**US$**	**q-o-q**	**y-o-y**	**q-o-q**	**y-o-y**
Total	**1,000**	**327**	**993**	**305**	**1,022**	**312**	**2.8**	**19.9**	**2.9**	**2.2**
Government	599	196	584	179	597	182	2.2	20.0	2.4	(0.2)
Central Government Bonds	440	144	468	143	482	147	3.7	12.2	3.1	9.5
of which: *sukuk*	146	48	166	51	175	53	5.8	29.9	5.4	19.9
Central Bank Bills	154	50	107	33	107	33	(3.0)	44.6	(0.5)	(30.8)
of which: *sukuk*	62	20	41	13	40	12	(1.6)	93.4	(2.5)	(35.3)
Sukuk Perumahan Kerajaan	5	1	9	3	9	3	73.1	–	0.0	97.8
Corporate	401	131	410	126	425	130	3.9	19.8	3.7	5.9
of which: *sukuk*	264	86	274	84	286	87	5.0	28.1	4.2	8.2

( ) = 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.

reach MYR1,022 billion at the end of 4Q13. Growth in the corporate bond market outpaced growth in the government bond sector, climbing 3.7% q-o-q and 5.9% y-o-y **(Table 1).**

Government Bonds. LCY government bonds outstanding stood at MYR597.5 billion at end-December, up 2.4% q-o-q but down 0.2% y-o-y. Central government bonds—comprising MGSs, Government Investment Issues (GIIs) and treasury bills—climbed to a record-high level of MYR481.9 billion. The size of outstanding BNM monetary notes, on the other hand, has shrunk every quarter since December 2012. The shares of conventional government bonds and government *sukuk* (Islamic bonds) remained at 63% and 37%, respectively, of total government bonds outstanding.

Government bond issuance rose 7.3% q-o-q to MYR90.9 billion in 4Q13, reversing a downward trend in place since December 2012, owing to issuance of central bank bills. Of the total issuance, the shares of conventional bonds and *sukuk* were almost equal at 49.6% and 50.4%, respectively.

In 2014, the government's borrowing requirements will be met primarily by re-opening bonds rather than issuing new debt. Malaysia's bond auction calendar shows a total of 32 offerings planned in 2014 versus 29 a year earlier. Compared with 2013, the auction plan for 2014 lacks new issuances, with only seven planned auctions versus 16 in 2013. The seven new issues will be spread over 1H14, which includes four auctions for MGSs, two for *Sukuk Perumahan Kerajaan* (SPK), and one for GIIs. The borrowing program was also skewed toward the belly of the curve (5- to 10-year maturities).

Corporate Bonds. Malaysia's LCY corporate bonds outstanding reached a record-high MYR424.7 billion at end-December, rising 3.7% q-o-q and 5.9% y-o-y. The increase is solely attributable to a spike in medium-term notes (MTNs), which amounted to MYR16.2 billion. The split between corporate *sukuk* and conventional corporate bonds remained constant, with corporate *sukuk* accounting for 67% of total corporate bonds and conventional corporate bonds comprising 33%.

Corporate bond issuance totaled MYR46.6 billion in 4Q13—the largest amount since June 2012 and double the level of issuance in 3Q13. A total of 100 corporate bond offerings, mostly *sukuk*, were issued by 66 corporate borrowers. Conventional bonds accounted for 32% of new corporate bond issues, down from 55% in the previous quarter; *sukuk* represented 68% of the total, up from 45%. **Table 2** lists some notable corporate bonds issued during 4Q13.

The largest corporate LCY issuer in 4Q13 was state-owned Cagamas, with total issuance of MYR7.0 billion, up from MYR1.2 billion in 3Q13. The breakdown of issuance by instrument is as follows: Islamic commercial paper

Table 2: Notable LCY Corporate Bond Issuance in 4Q13

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Cagamas		
3-month Islamic commercial paper	3.30	500
1-year Islamic MTN	3.40	485
3-year Islamic MTN	3.65 to 3.75	585
5-year Islamic MTN	3.95 to 4.05	350
7-year Islamic MTN	4.15 to 4.35	410
10-year Islamic MTN	4.30 to 4.60	650
12-year Islamic MTN	4.55	450
15-year Islamic MTN	4.75	675
20-year Islamic MTN	5.00	675
1-year MTN	3.35	120
3-year MTN	3.55	225
5-year MTN	3.90	300
7-year MTN	4.10	310
10-year MTN	4.30	375
12-year MTN	4.55	410
15-year MTN	4.75	460
BGSM Management		
1-year Islamic MTN	5.65	1,180.45
2-year Islamic MTN	5.75	917.65
3-year Islamic MTN	5.90	1,072.07
4-year Islamic MTN	6.10	1,081.76
5-year Islamic MTN	4.90	373
6-year Islamic MTN	6.60	738.88
7-year Islamic MTN	5.25	373
9-year Islamic MTN	7.10	760.24
10-year Islamic MTN	5.60	373
3-year MTN	3.75	15
Malakoff Power		
1-year Islamic MTN	4.10	500
2-year Islamic MTN	4.30	440
3-year Islamic MTN	4.50	100
5-year Islamic MTN	4.90	330
6-year Islamic MTN	5.05	670
7-year Islamic MTN	5.15	410
8-year Islamic MTN	5.25	500
9-year Islamic MTN	5.35	340
10-year Islamic MTN	5.45	320
11-year Islamic MTN	5.55	190
12-year Islamic MTN	5.65	140
13-year Islamic MTN	5.75	90
14-year Islamic MTN	5.85	90
15-year Islamic MTN	5.95	270
16-year Islamic MTN	6.05	370
17-year Islamic MTN	6.15	320
18-year Islamic MTN	6.25	300
10-year Subordinated MTN	4.80	1,000

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

(MYR500 million), conventional MTNs (MYR2.2 billion), and Islamic MTNs (MYR4.28 billion). On 28 October, Cagamas issued the single largest *Sukuk* Commodity *Murabahah* issuance in Malaysia amounting to MYR3.8 billion. The tenors ranged from 1 year to 20 years at profit rates of between 3.4% and 5.0%. The proceeds from the issuance will be used to tap Islamic financing. Cagamas was assigned LCY and foreign currency (FCY) long-term issuer ratings of A3 with a stable outlook by Moody's. Meanwhile, Cagamas MTNs were rated AAA by both Malaysian Rating Corp. (MARC) and RAM Ratings, and the Islamic MTNs received ratings of AAA-ID and AAA, respectively.

BGSM Management sold 1- to 10-year Islamic MTNs amounting to MYR6.9 billion with profit rates ranging from 4.9% to 7.1%. The proceeds will be used to refinance outstanding *sukuk*, US$-denominated loans, and bridging loans of BGSM. BGSM Management is an investment-holding company set up to facilitate the debt restructuring of BGSM. It owns an indirect 65% stake in Maxis Berhad (Maxis)—one of the major Malaysian mobile phone operators that offers voice and broadband services through its wireless and fixed telephony networks. The new issues were rated AA3 by RAM Ratings.

Malakoff Power issued 17 tranches of Islamic MTNs with tenures ranging between 1 year and 18 years, and profit rates between 4.1% and 6.25%. The total issuance size was RM5.38 billion, with the 5-year tenor comprising the largest tranche at MYR670 million. Malakoff Power is a wholly owned unit of Malakoff Corporation, the country's largest independent power producer with generating capacity of 5,020 megawatts. Malakoff Power was incorporated for the purpose of facilitating Malakoff Group's corporate restructuring. It will acquire the power plant operation and maintenance business of Malakoff and loan stocks in four independent power producers in which Malakoff has ownership interests. The notes were rated AA-IS by MARC with a stable outlook.

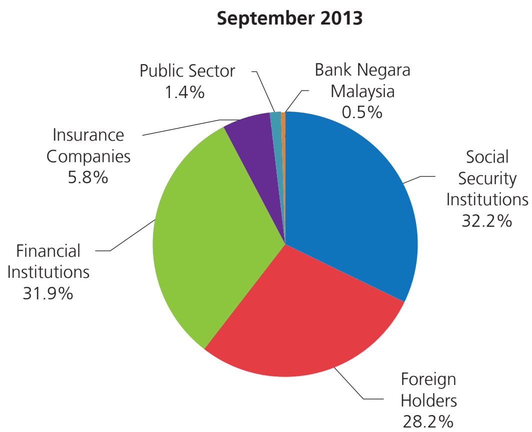
At end-December, the outstanding bonds of the top 30 corporate bond issuers in Malaysia amounted to MYR232.9 billion, accounting for 54.8% of the LCY corporate bond market **(Table 3)**. Project Lebuhraya remained the largest issuer of LCY corporate bonds with MYR30.6 billion outstanding, followed by Cagamas and Khazanah Nasional, with outstanding amounts of MYR24.7 billion and MYR18.7 billion, respectively.

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	30.60	9.34	No	Yes	Transport, Storage, and Communications
2. Cagamas	24.69	7.54	Yes	No	Finance
3. Khazanah	18.70	5.71	Yes	No	Quasi-Government
4. Prasarana	11.91	3.64	Yes	No	Transport, Storage, and Communications
5. Pengurusan Air	11.63	3.55	Yes	No	Energy, Gas, and Water
6. Maybank	9.70	2.96	No	Yes	Finance
7. CIMB Bank	8.05	2.46	No	No	Finance
8. Public Bank	7.02	2.14	Yes	No	Finance
9. BGSM Management	6.87	2.10	No	No	Transport, Storage, and Communications
10. Danainfra Nasional	6.50	1.98	Yes	No	Finance
11. Cagamas MBS	6.03	1.84	Yes	No	Finance
12. Perbadanan Tabung Pendidikan Tinggi Nasional	6.00	1.83	Yes	No	Quasi-Government
13. Malakoff Power	5.58	1.70	No	No	Energy, Gas, and Water
14. Senai Desaru Expressway	5.56	1.70	No	No	Construction
15. Sarawak Energy	5.50	1.68	Yes	No	Energy, Gas, and Water
16. Turus Pesawat	5.31	1.62	Yes	No	Quasi-Government
17. Putrajaya Holdings	5.26	1.61	No	No	Property and Real Estate
18. Aman *Sukuk*	5.03	1.54	Yes	No	Construction
19. AM Bank	5.01	1.53	No	No	Finance
20. Celcom Transmission	5.00	1.53	No	No	Transport, Storage, and Communications
21. 1Malaysia Development	5.00	1.53	Yes	No	Quasi-Government
22. Hong Leong Bank	4.86	1.48	No	Yes	Finance
23. KL International Airport	4.86	1.48	Yes	No	Transport, Storage, and Communications
24. Manjung Island Energy	4.85	1.48	No	No	Energy, Gas, and Water
25. RHB Bank	4.60	1.40	No	No	Finance
26. Tanjung Bin Power	4.05	1.23	No	Yes	Energy, Gas, and Water
27. Jimah Energy Ventures	3.88	1.18	No	No	Energy, Gas, and Water
28. YTL Power International	3.77	1.15	No	Yes	Energy, Gas, and Water
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	**232.91**	**71.10**			
Total LCY Corporate Bonds	**424.70**	**129.65**			
Top 30 as % of Total LCY Corporate Bonds	**54.8%**	**54.8%**			

LCY = local currency.
Notes:
1. Data as of end-December 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



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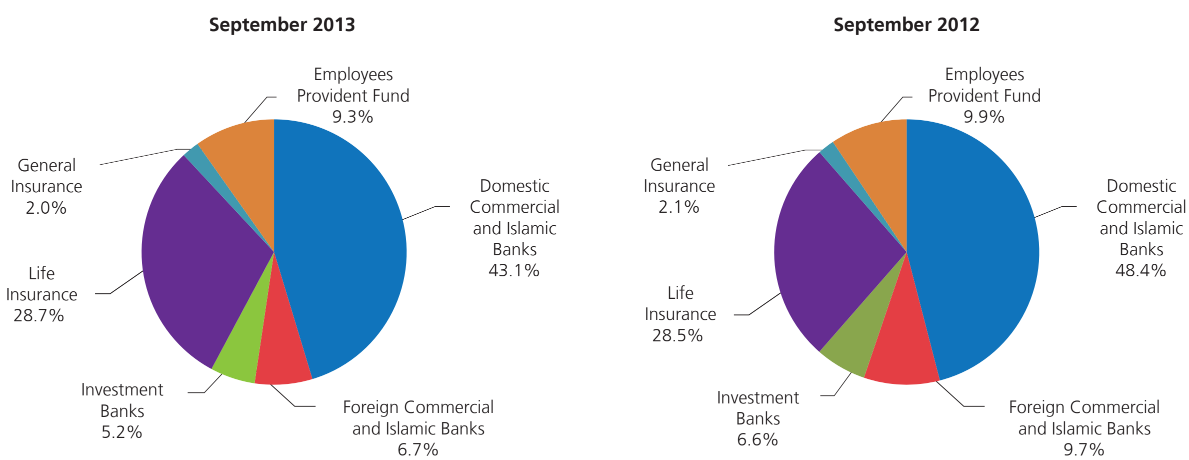

LCY = local currency.
Note: Employees Provident Fund as of end-2012.
Source: Bank Negara Malaysia.

Investor Profile

Social security institutions remain the dominant holders of MGSs and GIIs. Their holdings climbed to 32.2% of total government bonds outstanding at end-September **(Figure 2)** from 31.8% on the back of increased investments in GIIs by the Employees Provident Fund.

Holdings of financial institutions rose to 31.9% from 29.7% last year, driven by increased bank holdings of GIIs, while the share of foreign investors remained largely unchanged at 28.2% versus 28.9% a year earlier. In contrast, holdings of insurance companies dropped to 5.8% from 6.5%, as these institutions reduced their holdings of MGSs.

Domestic and foreign banks (commercial and Islamic) were the largest investor group in LCY corporate bonds at end-September with shares of 43.1% and 6.7%, respectively **(Figure 3)**. Compared with September 2012, the shares in corporate bonds dropped 5 percentage points for domestic banks and 3 percentage points for foreign banks. Investment banks also trimmed their position to 5.2% of total corporate bonds from 6.6% a year earlier, while insurance companies maintained their share of nearly 29% at end-September. In absolute terms, holdings of life insurance companies in corporate bonds rose MYR7.5 billion to MYR118.0 billion, which is more than double their MYR57 billion in holdings 6 years ago.

Rating Changes

Moody's Revises Outlook to Positive from Stable, Affirms A3 rating

On 20 November, Moody's revised Malaysia's outlook to positive from stable and affirmed its government bond and issuer ratings at A3. The change in the outlook was based on (i) improved prospects for fiscal consolidation and reform and (ii) continued macroeconomic stability in the face of external headwinds. Moody's noted that Malaysia's sovereign rating is supported by the government's favorable debt structure, depth of onshore capital markets, and high level of domestic savings. The rating agency further noted that Malaysia's economic resilience has been accompanied by price stability, which is anchored by the credibility of its central bank, BNM.

Policy, Institutional, and Regulatory Developments

Hong Kong, China and Malaysia Hold Joint Forum on Islamic Finance

On 3 December, the Hong Kong Monetary Authority (HKMA) and BNM facilitated a forum on Islamic finance, with participants from eight commercial banks and three fund management companies. The Financial Services and the Treasury Bureau of Hong Kong, China; the Securities and Futures Commission of Malaysia; and the Hong Kong Exchanges and Clearing Limited also joined the meeting.

The forum reviewed the current developments of Islamic finance globally and in both jurisdictions, and discussed measures to further the development of Hong Kong, China's Islamic financial market, particularly the *sukuk* market and the Islamic fund management industry.

The participants agreed to (i) identify potential *sukuk* issuers, particularly corporates, and encourage cross-border *sukuk* issuances between Hong Kong, China and Malaysia; and (ii) actively consider launching Islamic funds and making use of the established mutual recognition framework for Islamic funds between Hong Kong, China and Malaysia to facilitate cross-border Islamic financial activities.