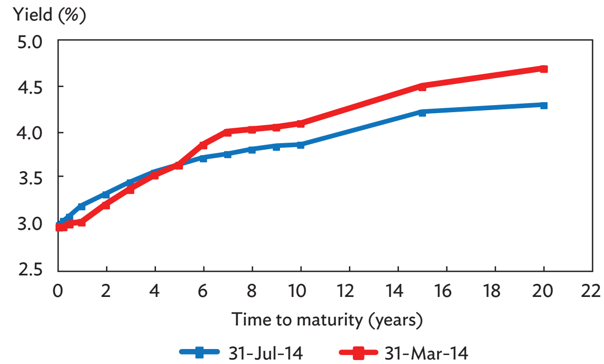
Malaysia

Yield Movements

Between end-March and end-July, Malaysia's local currency (LCY) government bond yields rose for short-term instruments with maturities of 5 years and less, while yields declined for longer-dated tenors (maturities of more than 6 years), resulting in a slight flattening of the curve **(Figure 1)**. Yields rallied the most for the 1-year tenor, which rose 17 basis points (bps), followed by the 2-year maturity, which gained 11 bps. Yields slumped at the longer-end of the curve, falling between 14 bps and 39 bps. The yield spread between 2- and 10-year tenors tightened to 53 bps at end-July from 87 bps at end-March.

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



LCY = local currency.
Source: Bloomberg LP.

Rising inflationary pressures, which were triggered in January by sugar and fuel subsidy rationalization, may have prompted bonds yields at the shorter-end to move higher. Consumer price inflation reached 3.5% year-on-year (y-o-y) in February—the fastest pace in 2.5 years—before easing to 3.3% in June. To guard against inflation and potential economic and financial imbalances, the Monetary Policy Committee of Bank Negara Malaysia (BNM) decided on 10 July to raise its overnight policy rate by 25 bps to 3.25%. This was the first rate hike since May 2011. BNM expects inflation to remain elevated and exceed its long-run average on higher domestic cost factors. The rate hike seeks to mitigate the risk of broader economic and financial imbalances that could undermine the growth prospects of the Malaysian economy.

These developments come as the economy re-gained positive momentum in 2014 and appeared poised to gather additional pace. Robust exports and private consumption drove economic growth higher in 2014. Real gross domestic product (GDP) growth accelerated to 6.4% y-o-y in 2Q14, the fastest pace in 6 quarters, from 6.2% in 1Q14. Exports advanced 8.8%—a significant reversal from the negative growth of 4.4% in 2Q13 and higher than the 7.8% growth recorded in 1Q14—contributing the bulk of GDP growth during the quarter. The expansion in exports was underpinned by both recovery in the advanced economies and regional demand. Private consumption grew 6.5% in 2Q14, down from a 7.1% gain in 1Q14. Buoyant private spending could be linked in part to a low unemployment rate of 3.1% and average real wages that rose an estimated 1.0% in 2Q14.

On the supply side, growth was fueled by increases in the manufacturing sector, which expanded 7.3% y-o-y in 2Q14, compared with 6.8% in 1Q14, led by electrical and electronics products, and transport equipment. Services climbed 6.0% in 2Q14, following a 6.6% rise in the previous quarter. On a seasonally adjusted and quarter-on-quarter (q-o-q) basis, the economy expanded 1.8%.

Size and Composition

Total LCY bonds outstanding in Malaysia rose 6.0% y-o-y to MYR1,053 billion (US$328.0 billion) at end-June, slightly lower than the pace of 6.4% in 2Q13, but higher than the 5.5% rise in 1Q14 **(Table 1)**. The corporate bond sector expanded faster than the government bond market on both a q-o-q and y-o-y basis. *Sukuk* (Islamic bonds) dominated the market, after surpassing conventional securities in terms of share of the total market in 1Q14, with 51.5% of bonds outstanding.

Government Bonds. LCY government bonds outstanding stood at MYR611.8 billion at end-June, up 4.1% y-o-y but down 0.3% q-o-q. Central government bonds, which accounted for 82.3% of total government bonds, led the increase with 10.7% y-o-y growth to MYR507.9 billion. In absolute terms, the increase in the outstanding amount of central government bonds was driven by Malaysian Government Securities (MGSs), up MYR156.0 billion, or 7.0% y-o-y, to MYR315.5 billion. Government Investment

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

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q13		1Q14		2Q14		2Q13		2Q14	
	MYR	US$	MYR	US$	MYR	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**994**	**314**	**1,051**	**322**	**1,053**	**328**	**(0.2)**	**6.4**	**0.2**	**6.0**
Government	588	186	614	188	612	191	(0.2)	5.1	(0.3)	4.1
Central Government Bonds	459	145	502	154	508	158	2.8	10.0	1.2	10.7
of which: *sukuk*	162	51	180	55	190	59	8.0	24.2	5.6	17.6
Central Bank Bills	123	39	99	30	88	28	(10.1)	(13.7)	(10.5)	(27.9)
of which: *sukuk*	51	16	41	12	35	11	(12.5)	(1.3)	(12.7)	(30.1)
Sukuk Perumahan Kerajaan	6	2.0	13	4	16	5	0.0	–	20.2	150.0
Corporate	406	128	438	134	442	138	(0.3)	8.2	0.9	8.7
of which: *sukuk*	272	86	298	91	302	94	(0.3)	13.0	1.4	11.1

( ) = 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.

Issues (GIIs) also made rapid gains, albeit from a low base, rising MYR28.5 billion, or 17.9% y-o-y, to MYR188.0 billion. Total central bank bills outstanding, on the other hand, plunged 27.9% y-o-y and 10.5% q-o-q, due to a decline in monetary note issuance by BNM.

The government issued more bonds in 2Q14 than in the previous quarter, with issuance rising 6.5% q-o-q to MYR92.4 billion, led by central government bills and central bank bills. On a y-o-y basis, however, the issuance of government bonds saw negative growth of 8.6% due to a drop in central bank bill issuance.

Corporate Bonds. LCY corporate bonds rose 8.7% y-o-y, bringing total outstanding bonds to MYR441.5 billion at end-June. The split between corporate *sukuk* and conventional bonds stood at 68.3% to 31.7%.

Islamic medium-term notes (IMTNs) were the most common instrument at 52.4% of total corporate bonds and 76.7% of total *sukuk* outstanding at end-June. IMTNs are sold in smaller amounts compared with corporate bonds and provide semi-annual dividends depending on the structure used.

Corporate issuance contracted 13.4% q-o-q to MYR26.6 billion in 2Q14. A total of 88 new issues were completed during the quarter. *Sukuk* remained the preferred structure of corporate debt financing and accounted for over 60%, or MYR16.3 billion, of new corporate issuance in 2Q14. **Table 2** lists some notable corporate bonds issued in 2Q14.

Table 2: Notable LCY Corporate Bond Issuance in 2Q14

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Danainfra Nasional		
7-year Islamic MTN	4.40	500
10-year Islamic MTN	4.55	500
15-year Islamic MTN	5.03	200
20-year Islamic MTN	5.25	300
25-year Islamic MTN	5.38	700
30-year Islamic MTN	5.51	400
Aman *Sukuk*		
3-year Islamic MTN	4.00	260
5-year Islamic MTN	4.30	305
7-year Islamic MTN	4.53	310
10-year Islamic MTN	4.78	355
12-year Islamic MTN	4.93	245
15- year Islamic MTN	5.13	105
Midciti *Sukuk*		
3-year Islamic MTN	3.90	300
5-year Islamic MTN	4.20	400
7-year Islamic MTN	4.55	400
10-year Islamic MTN	4.80	455

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

The largest corporate issuer in 2Q14 was DanaInfra Nasional, a company wholly owned by the Ministry of Finance to raise funds for infrastructure projects assigned by the government. DanaInfra raised MYR2.6 billion from six tranches of government-guaranteed IMTNs with maturities ranging from 7 years to 30 years. Profit rates ranged from 4.40% to 5.51%, which were 40 bps–56 bps more than sovereign non-Islamic notes with similar maturities, and about 35bps–45bps higher than existing *sukuk* with similar tenors issued in October 2013. Proceeds of the sale will be spent on expanding Mass Rapid Transit rail network coverage in the Klang Valley and Kuala Lumpur.

Other notable issuers in 2Q14 included government-owned special purpose vehicles. Aman Sukuk issued six tranches of IMTNs amounting to MYR1.58 billion and with profit rates ranging from 4.00% to 5.13% for tenures of between 3 years and 15 years. The IMTNs were assigned an AAAIS rating by MARC and given a stable outlook. Aman Sukuk is the funding vehicle for Pembinaan BLT, a unit wholly owned by the Government of Malaysia and established to build facilities for the Royal Malaysia Police. Meanwhile, Midciti Sukuk issued a total of MYR1.55 billion of IMTNs with profit rates ranging from 3.9% to 4.8%. The IMTNs were rated AAA by RAM Ratings and given a stable outlook. Midciti Sukuk is a wholly owned funding vehicle of KLCC Real Estate Investment Trust, which owns PETRONAS Twin Towers, Menara 3 Petronas, and Menara ExxonMobil.

Table 3 provides a breakdown of the top 30 LCY corporate bond issuers in Malaysia, whose total LCY bonds outstanding stood at MYR240.5 billion at end-June, representing 54.5% of the LCY corporate bond market. Financial firms comprised 10 of the 30 largest corporate bond issuers, with bonds outstanding worth MYR83.8 billion.

Highway operator Project Lebuhraya Usahasama remained the largest issuer with outstanding bonds valued at MYR30.6 billion.

Investor Profile

Financial institutions—including banking institutions, development financial institutions, and non-bank financial institutions—saw the largest increase in their holdings of government bonds, which rose MYR43.7 billion, or 39.2% y-o-y, in 1Q14. Financial institutions accounted for a 32.7% share of total outstanding government bonds at end-March **(Figure 2)**. Social security institutions saw the largest decrease in their holdings by 3 percentage points, followed by foreign investors and insurance companies, which reduced their holdings by 2.4 percentage points and 0.9 points, respectively.

Domestic banks (commercial and Islamic) decreased their holdings of LCY corporate bonds but still remained the largest investor group at end-June with a share of 46.8% of corporate bonds outstanding **(Figure 3)**. Life insurance companies are the only investor group that have consistently increased their investments in LCY corporate bonds since 2006, increasing holdings by MYR11.1 billion on an annual basis in 2Q14 to reach MYR130.3 billion, or 31.5% of the LCY corporate bond market.

Rating Changes

On 23 July, Fitch Ratings affirmed a negative credit outlook for Malaysia, while also affirming the long-term foreign currency and LCY issuer default ratings at A– and A, respectively. Fitch Ratings maintains that the country's key sovereign weakness stems from its public finances, the same reason it provided for its downgrade last year. The credit rating agency is also concerned that (i) the path to achieving the government's budget deficit targets remains unclear as the impact of the new goods and services tax has yet to be determined, (ii) the current account might shift into a deficit amid heavy public sector deficits, and (iii) rising household debt could magnify the impact of any future macroeconomic volatility on the credit profile.

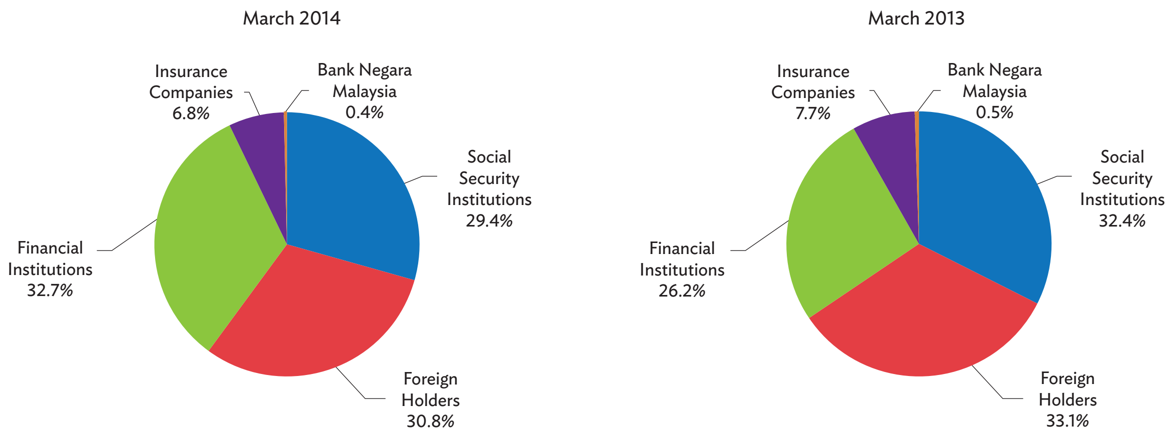
On 24 July, Standard & Poor's likewise affirmed Malaysia's A– and A long-term foreign currency and LCY ratings, respectively, with a stable outlook for both. Standard & Poor's asserts that Malaysia's strong external asset position, which is expected to see stronger trade surpluses in the next 2–3 years, and its high degree of monetary flexibility, demonstrated by a track record of controlling inflation, balances its moderate fiscal deficits and government debt burden.

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	9.53	No	Yes	Transport, Storage, and Communications
2.	Cagamas	24.00	7.47	Yes	No	Finance
3.	Khazanah	20.00	6.23	Yes	No	Quasi-Government
4.	Prasarana	13.91	4.33	Yes	No	Transport, Storage, and Communications
5.	Pengurusan Air	11.73	3.65	Yes	No	Energy, Gas, and Water
6.	Maybank	11.30	3.52	No	Yes	Finance
7.	Danainfra Nasional	9.10	2.83	Yes	No	Finance
8.	Perbadanan Tabung Pendidikan Tinggi Nasional	8.50	2.65	Yes	No	Quasi-Government
9.	CIMB Bank	8.05	2.51	No	No	Finance
10.	Public Bank	8.02	2.50	No	Yes	Finance
11.	BGSM Management	7.20	2.24	No	No	Transport, Storage, and Communications
12.	Aman *Sukuk*	6.44	2.01	Yes	No	Construction
13.	Cagamas MBS	5.76	1.79	Yes	No	Finance
14.	Sarawak Energy	5.50	1.71	Yes	No	Energy, Gas, and Water
15.	Malakoff Power	5.38	1.68	No	No	Energy, Gas, and Water
16.	Turus Pesawat	5.31	1.65	Yes	No	Quasi-Government
17.	Celcom Transmission	5.00	1.56	No	No	Transport, Storage, and Communications
18.	1Malaysia Development	5.00	1.56	Yes	No	Quasi-Government
19.	Hong Leong Bank	4.95	1.54	No	Yes	Finance
20.	Manjung Island Energy	4.85	1.51	No	No	Energy, Gas, and Water
21.	RHB Bank	4.60	1.43	No	No	Finance
22.	AM Bank	4.54	1.41	No	No	Finance
23.	Putrajaya Holdings	4.43	1.38	No	No	Property and Real Estate
24.	KL International Airport	4.36	1.36	Yes	No	Transport, Storage, and Communications
25.	Tanjung Bin Power	4.05	1.26	No	Yes	Energy, Gas, and Water
26.	YTL Power International	3.77	1.17	No	Yes	Energy, Gas, and Water
27.	Jimah Energy Ventures	3.71	1.16	No	No	Energy, Gas, and Water
28.	TNB Western Energy	3.66	1.14	No	No	Construction
29.	Cekap Mentari	3.50	1.09	Yes	No	Finance
30.	Rantau Abang	3.30	1.03	Yes	No	Quasi-Government
Total Top 30 LCY Corporate Issuers		**240.51**	**74.90**			
Total LCY Corporate Bonds		**441.54**	**137.51**			
Top 30 as % of Total LCY Corporate Bonds		**54.5%**	**54.5%**			

LCY = local currency.
Notes:
1. Data as of end-June 2014.
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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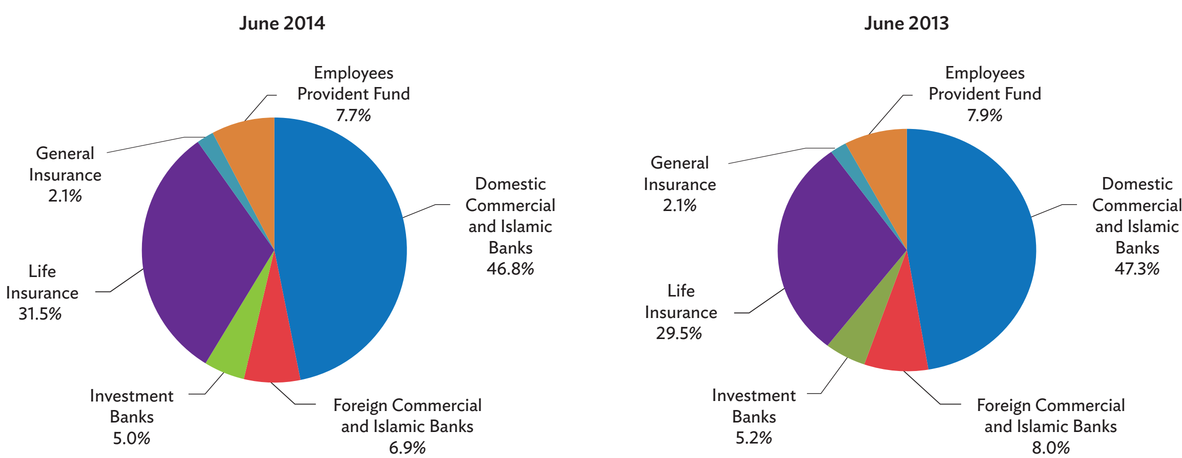

LCY = local currency.
Note: Employees Provident Fund as of end-2012.
Source: Bank Negara Malaysia.

Policy, Institutional, and Regulatory Developments

Prime Minister Announces Liberalization Measures

In June, Prime Minister Najib Razak announced several measures aimed at liberalizing Malaysia's financial sector. Effective immediately, the barriers for new foreign unit trust management companies entering Malaysia were lifted. Effective 1 January 2015, credit rating agencies will be given more flexibility in the trading of unrated bonds and *sukuk*. Effective 1 January 2017, mandatory credit ratings for new corporate issues will be removed and full foreign ownership of international credit rating agencies will be allowed. The liberalization program seeks to strengthen the country's capital market in support of sustainable, long-term growth.