Malaysia

Yield Movements

Between 1 June and 14 August, Malaysian local currency (LCY) government bond yields rose for all tenors as the market remained cautious over domestic and external developments **(Figure 1)**. Yields for tenors of less than 1 year increased between 14 basis points (bps) and 16 bps, while yields for tenors of 1 year to 20 years rose between 27 bps and 44 bps.

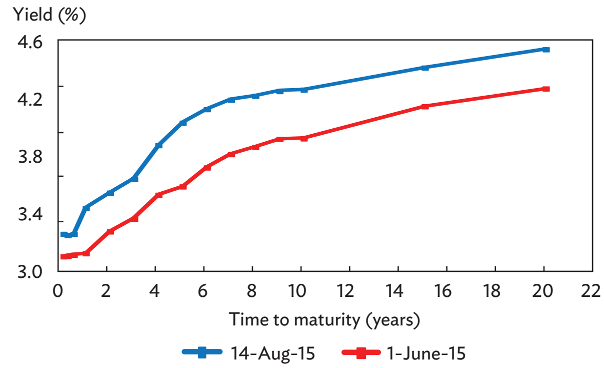
Yields rose as the market continued to monitor economic developments in the United States (US) that might signal the start of rate hikes by the US Federal Reserve. In August, concerns over the slowdown of the economy of the People's Republic of China and the devaluation of the Chinese renminbi further contributed to the rise in yields and the sharp depreciation of the Malaysian ringgit.

As of 14 August, the ringgit had depreciated 16.7% year-to-date. The weakness of the currency is a reflection of the market's bearish outlook on Malaysia's economic growth and fiscal condition amid the continued decline in global oil prices, and impact of the PRC's economic slowdown. In addition, the market has also taken note of the fall in Bank Negara Malaysia's (BNM) foreign reserves to below US$100 billion in July, an indication that BNM has been intervening to support the Malaysian ringgit. The decline in foreign reserves increases Malaysia's vulnerability to further capital outflows.

The continued depreciation of the Malaysian ringgit against the US dollar resulted in foreign investors selling off their holdings of local bonds. Data from BNM showed a decline in foreign holdings of central government debt securities to MYR177 billion in July from MYR180 billion in June, the largest recorded monthly outflow year-to-date.

Furthermore, inflation continues to be on an upward trend rising to 3.3% year-on-year (y-o-y) at end-July from 0.9% y-o-y at end-March raising speculations that the BNM may raise policy rates to abate inflation. The rise in inflation was primarily due to upward adjustments in domestic fuel prices and the effects of the Goods and Services Tax (GST).

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



LCY = local currency.
Source: Bloomberg LP.

In its policy meeting held on 9 July, BNM decided to maintain its overnight policy rate at 3.25% stating that Malaysia's economy is expected to continue to grow moderately with support from domestic demand. Private consumption is expected to be slower due to the effects of the implementation of the GST, but will continue to be supported by stable domestic labor market conditions. Inflation is expected to increase in the short-term, due to implementation of the GST and adjustments in fuel prices, before moderating in the second half of 2016.

Meanwhile, Malaysia's gross domestic product growth slowed to 4.9% y-o-y in 2Q15 from 5.6% y-o-y in 1Q15, due to weaker private final consumption expenditure and gross fixed capital formation, and a contraction in exports. Private final consumption expenditure posted an increase of 6.4% y-o-y in 2Q15, down from 8.8% in 1Q15, while gross fixed capital formation growth slowed to 0.5% y-o-y from 7.9% y-o-y. Exports contracted 3.7% y-o-y in 2Q15.

Size and Composition

The Malaysian LCY bond market barely moved in 2Q15, expanding a mere 0.2% quarter-on-quarter (q-o-q) to MYR1,076 billion (US$285 billion) at end-June **(Table 1)**. The increases in the stock of outstanding central government bonds, corporate bonds, and *Sukuk*

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

	Outstanding Amount (billion)						Growth Rate (%)			
	2Q14		1Q15		2Q15		2Q14		2Q15	
	MYR	US$	MYR	US$	MYR	US$	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,053**	**328**	**1,073**	**290**	**1,076**	**285**	**0.2**	**6.0**	**0.2**	**2.1**
Government	612	191	612	165	608	161	(0.3)	4.1	(0.7)	(0.6)
Central Government Bonds	508	158	531	143	557	148	1.2	10.7	4.9	9.6
of which: *sukuk*	190	59	195	53	209	55	5.6	17.6	7.1	9.9
Central Bank Bills	88	28	57	15	23	6	(10.5)	(27.9)	(59.1)	(73.6)
of which: *sukuk*	35	11	19	5	4	1	(12.7)	(30.1)	(78.4)	(88.1)
Sukuk Perumahan Kerajaan	16	5	24	7	28	7	20.2	150.0	14.3	80.0
Corporate	442	138	461	125	468	124	0.9	8.7	1.4	6.0
of which: *sukuk*	302	94	328	89	337	89	1.4	11.1	2.7	11.8

( ) = negative, 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.

Perumahan Kerajaan were capped by the continued decrease in outstanding central bank bills.[7] There was still no issuance of BNM monetary notes in 2Q15. On a y-o-y basis, the LCY bond market grew 2.1% in 2Q15. Government bonds outstanding totaled MYR608 billion (US$161 billion), while corporate bonds summed to MYR468 billion (US$124 billion). *Sukuk* (Islamic bonds) continued to comprise the majority of the LCY bond market with a share of 54% of total bonds outstanding at end-June.

Government Bonds. LCY government bonds outstanding decreased 0.7% q-o-q and 0.6% y-o-y to close at MYR608 billion at end-June. This was due to the continued decline in outstanding BNM monetary notes, which contracted 59.1% q-o-q to MYR23 billion. The central bank ceased issuance of BNM monetary notes—a tool used to manage liquidity in the market—in the first half of 2015 amid easing inflation. Meanwhile, central government bonds—comprising Malaysian Government Securities, Government Investment Issues, and Treasury bills—increased 4.9% q-o-q to MYR557 billion.

Total government bond issuance increased 4.4% q-o-q to MYR32 billion, led by Government Investment Issues. Meanwhile, there was a lesser amount of Malaysian Government Securities and Treasury bills issued in 2Q15.

[7] *Sukuk Perumahan Kerajaan* are Islamic bonds issued by the government to refinance funding for housing loans to government employee and to extend new housing loans.

Corporate Bonds. LCY corporate bonds slightly increased 1.4% q-o-q, bringing total outstanding bonds to MYR468 billion at end-June. The ratio of corporate *sukuk* to total corporate bonds outstanding inched up to 72.1% at end-June from 71.2% at end-March.

Corporate bond issuance rose 60.6% q-o-q to MYR30 billion in 2Q15 (on a total of 53 new issues) from a low base of MYR19 billion in 1Q15. *Sukuk* accounted for the majority of total issuance for the quarter with a share of 64.2%, while conventional bonds registered a share of 35.8%. By type of instrument, Islamic Medium-Term Notes had the highest share of total issuance at 57.8%, next was conventional commercial paper with a share of 27.3%. **Table 2** lists notable corporate bond issuances in 2Q15.

The largest corporate issuers in 2Q15 were from the financial and transportation sectors, led by Danainfra Nasional, Danga Capital, Jambatan Kedua, and Jana Kapital. Danainfra Nasional, a state-owned company established to fund Malaysia's infrastructure projects, issued a multi-tranche *sukuk* comprising a MYR600 million 7-year tranche: MYR300 million each for the 10-year, 15-year, and 20-year tranches; and MYR1 billion each for the 25-year and 30-year tranches. The notes carried 4.15%, 4.33%, 4.61%, 4.79%, 4.95%, and 5.05% profit rates, respectively. Danga Capital issued MYR2 billion worth of 5-year *sukuk* with a profit rate of 4.1%. The bond was rated AAA by RAM Ratings.

Table 2: Notable LCY Corporate Bond Issuance in 2Q15

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Danainfra Nasional		
7-year Islamic MTN	4.15	600
10-year Islamic MTN	4.33	300
15-year Islamic MTN	4.61	300
20-year Islamic MTN	4.79	300
25-year Islamic MTN	4.95	1,000
30-year Islamic MTN	5.05	1,000
Danga		
5-year Islamic MTN	4.10	2,000
Jambatan Kedua		
10-year Islamic MTN	4.30	1,300
15-year Islamic MTN	4.52	700
Jana Kapital		
1-year Islamic MTN	4.30	35
2-year Islamic MTN	4.40	100
3-year Islamic MTN	4.50	100
4-year Islamic MTN	4.60	95
5-year Islamic MTN	4.70	95
6-year Islamic MTN	4.80	100
7-year Islamic MTN	4.90	95
8-year Islamic MTN	5.00	95
9-year Islamic MTN	5.10	95
10-year Islamic MTN	5.20	90
Benih Restu		
10-year Islamic MTN	4.62	1,000
United Overseas Bank Malaysia		
10-year Islamic MTN	4.62	1,000

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

Table 3 provides a breakdown of the top 30 LCY corporate bond issuers in Malaysia, whose total LCY bonds outstanding stood at MYR253.9 billion at end-June, representing 54.3% of the LCY corporate bond market. Financial firms, including banks, comprised 15 of the 30 largest corporate bond issuers, with bonds outstanding worth MYR135.6 billion. Highway operator Project Lebuhraya Usahasama remained the largest issuer with outstanding bonds valued at MYR30.6 billion.

Investor Profile

At end-June, foreign investors held the largest share of government bonds at 33.8%, with a total value of MYR180.1 billion, compared to the same period in 2014 when financial institutions had the largest holdings. The share of government bonds held by financial institutions—including banks, development financial institutions, and nonbank financial institutions—declined to 32.3% from 34.0% at end-June 2014 **(Figure 2)**.

Meanwhile, the share of social security institutions inched up to 27.8% of the total market at end-June from 27.3% a year earlier. The share of insurance companies' government bond holdings fell to 5.7% at end-June from 6.5% a year earlier.

Domestic and foreign banks (commercial and Islamic) remained the largest investor group in LCY corporate bonds at end-June with shares of 47.5% and 5.8%, respectively **(Figure 3)**. Compared with a year earlier, the share of domestic banks increased 1.2 percentage points, while that of foreign banks decreased 1.0 percentage point. The share of life insurance companies increased slightly to 31.7% at end-June from 31.2% a year earlier. Meanwhile, the share of investment banks remained unchanged at 4.9%.

Ratings Update

In July, Fitch Ratings (Fitch) affirmed its A– long-term foreign currency issuer default rating and A long-term local currency issuer default rating for Malaysia. The outlook for both ratings was revised to stable from negative. Fitch cited Malaysia's improving fiscal position, strong real economic growth, and stable inflation as the reasons for its ratings decisions.

Also in July, Standard & Poor's (S&P) affirmed its A–/A-2 foreign currency issuer default rating and A/A-1 local currency issuer default rating for Malaysia, with a stable outlook for both ratings. S&P cited Malaysia's strong external position and monetary flexibility as the reasons for its ratings decisions. S&P also stated that the 1Malaysia Development corruption controversy will not affect the government's implementation of fiscal and economic reforms.

Policy, Institutional, and Regulatory Developments

BNM to Create Comprehensive Guidelines on Major Islamic Finance Contracts

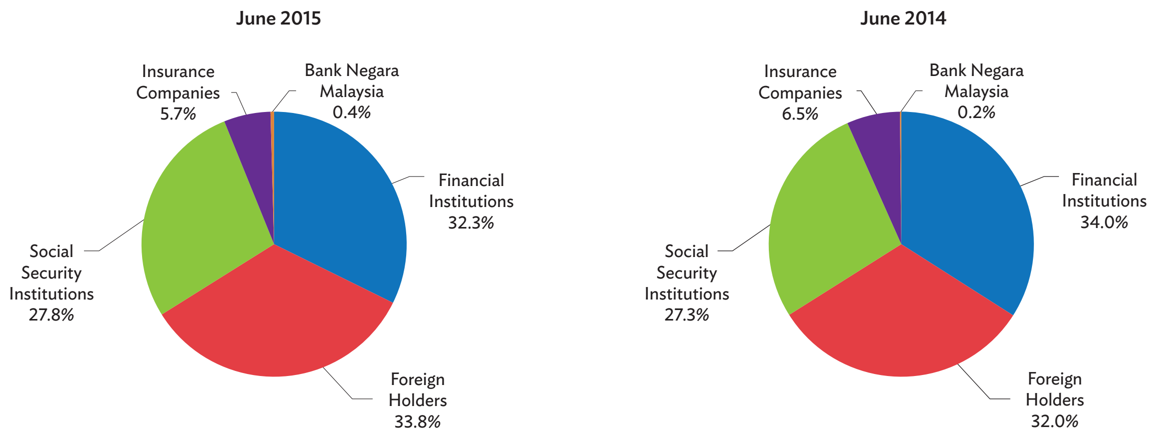
In June, BNM announced that it will create a comprehensive set of guidelines for all major Islamic finance contracts, including the finalization of operating

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	30.6	8.1	No	No	Transport, Storage, and Communications
2.	Cagamas	22.2	5.9	Yes	No	Finance
3.	Khazanah	20.0	5.3	Yes	No	Finance
4.	Danainfra Nasional	17.6	4.7	Yes	No	Finance
5.	Prasarana	15.6	4.1	Yes	No	Transport, Storage, and Communications
6.	Pengurusan Air	11.9	3.2	Yes	No	Energy, Gas, and Water
7.	Maybank	11.4	3.0	No	Yes	Banking
8.	Perbadanan Tabung Pendidikan Tinggi Nasional	11.0	2.9	Yes	No	Finance
9.	CIMB Bank	8.1	2.1	No	No	Banking
10.	Public Bank	7.6	2.0	No	No	Banking
11.	Sarawak Energy	7.0	1.9	Yes	No	Energy, Gas, and Water
12.	Aman Sukuk	6.7	1.8	Yes	No	Construction
13.	BGSM Management	6.0	1.6	No	No	Transport, Storage, and Communications
14.	RHB Bank	5.4	1.4	No	No	Banking
15.	Turus Pesawat	5.3	1.4	Yes	No	Transport, Storage, and Communications
16.	Cagamas MBS	5.0	1.3	Yes	No	Finance
17.	1Malaysia Development	5.0	1.3	Yes	No	Finance
18.	Celcom Networks	5.0	1.3	No	No	Transport, Storage, and Communications
19.	Malakoff Power	4.9	1.3	No	No	Energy, Gas, and Water
20.	Manjung Island Energy	4.9	1.3	No	No	Energy, Gas, and Water
21.	Rantau Abang	4.8	1.3	Yes	No	Finance
22.	YTL Power International	4.8	1.3	No	Yes	Energy, Gas, and Water
23.	Hong Leong Bank	4.7	1.2	No	Yes	Banking
24.	AM Bank	4.5	1.2	No	Yes	Banking
25.	Bank Pembangunan Malaysia	4.4	1.2	Yes	No	Banking
26.	Putrajaya Holdings	4.2	1.1	Yes	No	Property and Real Estate
27.	Tanjung Bin Power	4.0	1.1	No	No	Energy, Gas, and Water
28.	Danga Capital	4.0	1.1	Yes	No	Finance
29.	Telekom Malaysia	3.7	1.0	No	Yes	Transport, Storage, and Communications
30.	TNB Western Energy	3.7	1.0	Yes	No	Energy, Gas, and Water
Total Top 30 LCY Corporate Issuers		**253.9**	**67.3**			
Total LCY Corporate Bonds		**467.9**	**124.0**			
Top 30 as % of Total LCY Corporate Bonds		**54.3%**	**54.3%**			

LCY = local currency.
Notes:
1. Data as of end-June 2015.
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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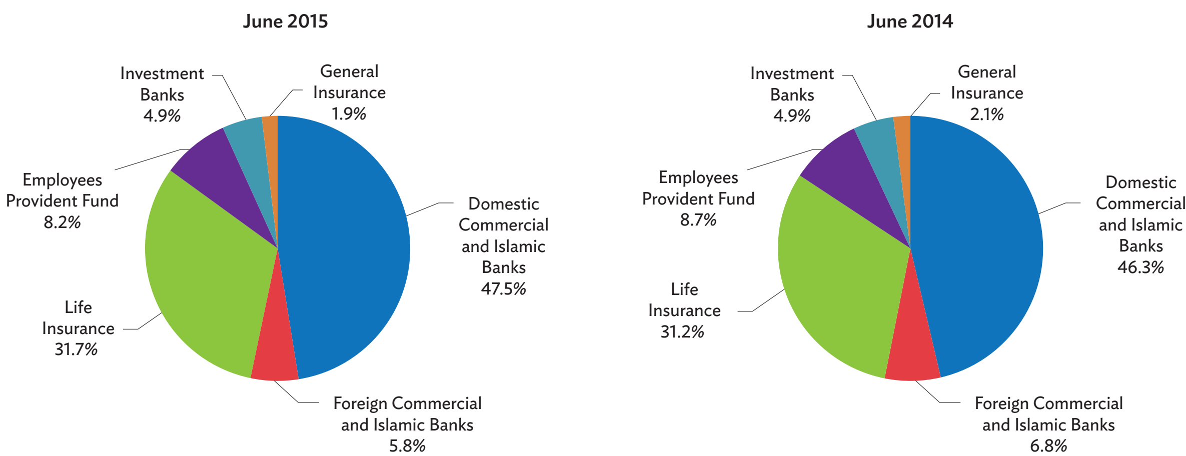

LCY = local currency.
Note: The Employees Provident Fund's (EPF) bond holdings data is as of end-December 2014, as data is based on the EPF's annual report.
Source: Bank Negara Malaysia.

standards, by the end of the year. The guidelines will address inconsistencies in the use and interpretation of Islamic contracts, and will complement the existing *shari'ah* guidelines already issued by BNM.

SC Implements Lodge and Launch Framework for Wholesale Products

On 15 June, the Securities Commission Malaysia (SC) implemented the Lodge and Launch Framework for wholesale products, which incorporate the Guidelines on Unlisted Capital Market Products issued on 29 March. This initiative is expected to significantly reduce the time-to-market for wholesale products from the current approval timeframe of 14–21 days. The Lodge and Launch Framework enables wholesale products to be launched to the market once all required information is submitted via the SC's online system. The wholesale products covered under this initiative include wholesale funds, structured products, bonds, *sukuk*, and asset-backed securities.