

## Malaysia

### Yield Movements

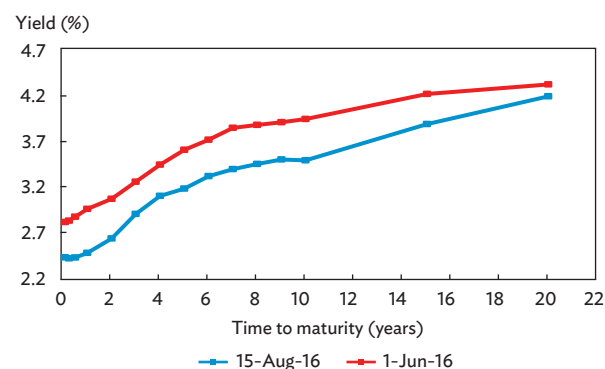
Between 1 June and 15 August, Malaysian local currency (LCY) government bond yields fell for all tenors on lowered expectations of a United States Federal Reserve interest rate hike this year and the unexpected policy rate cut by Bank Negara Malaysia (BNM) in July (**Figure 1**). Except for the 20-year tenor, which fell only 13 basis points (bps), yields for all tenors fell 41 bps on average. The 2-year versus 10-year spread was barely changed during the review period at 85 bps from 87 bps.

In its monetary policy meeting on 13 July, BNM decided to lower its overnight policy rate by 25 bps to 3.0%. The ceiling and floor rates for the overnight policy rate corridor were also reduced to 3.25% and 2.75%, respectively. BNM's decision to cut rates was seen by the market as a preemptive move due to heightened risks to global and domestic growth prospects, following the United Kingdom's referendum on leaving the European Union, commonly known as "Brexit." Brexit has also further dampened market expectations of a Federal Reserve rate hike this year, providing more support to domestic bonds.

Foreign holdings of LCY bonds remained high in the second quarter (Q2) of 2016 as demand for higher-yielding emerging East Asian LCY bonds persists amid low global interest rates. Data from BNM showed an increase in foreign holdings of central government debt securities from MYR191 billion in March to MYR207 billion in June and to MYR213 billion in July. As a result, the Malaysian ringgit remained supported during the review period despite a temporary depreciation due to Brexit and oil price volatilities.

Inflation continued to decelerate from 2.6% year-on-year (y-o-y) in March to 1.6% y-o-y in June and further to 1.1% y-o-y in July, as communications and transportation prices continued to post y-o-y decreases. In its monetary policy meeting on 13 July, BNM lowered its forecast for full-year 2016 inflation to 2.0%–3.0% from 2.5%–3.5%, citing as reasons the lapse in the impact of the Goods and Services Tax implemented last year and low global energy prices.

**Figure 1: Malaysia's Benchmark Yield Curve—Local Currency Government Bonds**



Source: Based on data from Bloomberg LP.

Malaysia's economic growth slowed to 4.0% y-o-y in Q2 2016 from 4.2% y-o-y in Q1 2016, primarily due to an accelerated contraction in the agriculture sector of 7.9% y-o-y following a decline of 3.8% y-o-y in Q1 2016. All other industries posted annual increases in Q2 2016. The slower growth was driven by continued weakness in exports, which increased 1.0% y-o-y in Q2 2016. On the other hand, economic growth was supported by the accelerated increase in gross fixed capital formation of 6.1% y-o-y in Q2 2016, up from only 0.1% y-o-y in the previous quarter. Private final consumption expenditure and government spending also posted larger annual increases in Q2 2016.

### Size and Composition

The Malaysian LCY bond market grew 2.0% quarter-on-quarter (q-o-q) to MYR1,163 billion (USD289 billion) at the end of June (**Table 1**). The rise was most notable in the government bond sector as the amount of outstanding corporate bonds barely changed from the previous quarter. On a y-o-y basis, the LCY bond market expanded at a faster pace of 8.2%. Total government bonds outstanding amounted to MYR644 billion, while corporate bonds totaled MYR519 billion. The share of *sukuk* (Islamic bonds) in Malaysia's LCY bond market continued to exceed that of conventional bonds, with a majority share of 55% at the end of June.

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

	Outstanding Amount (billion)						Growth Rate (%)			
	Q2 2015		Q1 2016		Q2 2016		Q2 2015		Q2 2016	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
<b>Total</b>	<b>1,076</b>	<b>285</b>	<b>1,141</b>	<b>293</b>	<b>1,163</b>	<b>289</b>	<b>0.2</b>	<b>2.1</b>	<b>2.0</b>	<b>8.2</b>
Government	608	161	628	161	644	160	(0.7)	(0.6)	2.5	5.9
Central Government Bonds	557	148	579	148	600	149	4.9	9.6	3.8	7.9
of which: <i>Sukuk</i>	209	55	223	57	232	57	7.1	9.9	3.9	10.8
Central Bank Bills	23	6	22	6	15	4	(59.1)	(73.6)	(29.1)	(34.5)
of which: <i>Sukuk</i>	4	1	0	0	0	0	(78.4)	(88.1)	–	(100.0)
Sukuk Perumahan Kerajaan	28	7	28	7	28	7	14.3	80.0	0.0	1.8
Corporate	468	124	512	131	519	129	1.4	6.0	1.4	11.0
of which: <i>Sukuk</i>	337	89	366	94	375	93	2.7	11.8	2.5	11.3

( ) = negative, – = not applicable, MYR = Malaysian ringgit, q-o-q = quarter-on-quarter, Q1 = first quarter, Q2 = second quarter, USD = United States dollar, y-o-y = year-on-year.

Notes:

1. Calculated using data from national sources.
2. Bloomberg LP end-of-period local currency–USD rate is used.
3. Growth rates are calculated from local currency base and do not include currency effects.
4. Sukuk Perumahan Kerajaan are Islamic bonds issued by the Government of Malaysia to refinance funding for housing loans to government employees and to extend new housing loans.

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

**Government Bonds.** LCY government bonds outstanding increased 2.5% q-o-q to MYR644 billion at the end of June, led by increases in the outstanding stock of Malaysian Government Securities and Government Investment Issues. Meanwhile, the outstanding stock of central bank bills continued to decline. On a y-o-y basis, government bonds outstanding rose 5.9% in Q2 2016.

Government bond issuance in Q2 2016 was almost on par with the previous quarter as the higher issuance of Malaysian Government Securities was offset by lower issuance of Government Investment Issues and Treasury bills.

**Corporate Bonds.** LCY corporate bonds slightly increased 1.4% q-o-q to MYR519 billion at the end of June from MYR512 billion at the end of March. *Sukuk* continued to dominate the Malaysian LCY corporate bond market with their share of the total rising to 72.2% in Q2 2016 from 71.4% in Q1 2016.

At the end of June, the aggregate bonds outstanding of the top 32 LCY corporate bond issuers in Malaysia amounted to MYR295.3 billion, or 56.8% of the total LCY corporate bond market (**Table 2**). Financial firms, including banks, comprised the majority of the 32 largest corporate bond issuers with total bonds outstanding worth MYR163.6 billion. Highway operator Project

Lebuhraya Usahasama remained the largest issuer with outstanding bonds valued at MYR30.6 billion, followed by state-owned mortgage firm Cagamas with MYR26.3 billion.

Issuance of corporate bonds increased slightly to MYR34.1 billion in Q2 2016 from MYR33.5 billion in Q1 2016. *Sukuk* issuance continued to exceed that of conventional bonds, with their share of total issuance rising to 58.9% at the end of June from 55.4% at the end of March. By type of instrument, Islamic medium-term notes had the highest share of total issuance at 43.2%, followed by conventional commercial paper with a share of 25.7%. **Table 3** lists the notable corporate bond issuances in Q2 2016.

The largest corporate bond issuers in Q2 2016 were from government-owned entities, mostly in the utilities sector. Sarawak Energy, an electricity generator and transmitter company, issued Islamic medium-term notes comprising an MYR800 million 15-year tranche and a MYR700 million 20-year tranche with coupon rates of 5.04% and 5.18%, respectively. Pengurusan Air SPV, a water services company, also issued Islamic medium-term notes comprising a MYR400 million 5-year tranche, an MYR800 million 7-year tranche, and a MYR250 million 10-year tranche with coupon rates of 4.04%, 4.23%, and 4.40%, respectively.

Table 2: Top 32 Issuers of Local Currency Corporate Bonds in Malaysia

	Issuers	Outstanding Amount		State-Owned	Listed Company	Type of Industry
		LCY Bonds (MYR billion)	LCY Bonds (USD billion)			
1.	Project Lebuhraya Usahasama	30.6	7.6	No	No	Transport, Storage, and Communications
2.	Cagamas	26.3	6.5	Yes	No	Finance
3.	Danainfra Nasional	25.2	6.3	Yes	No	Finance
4.	Prasarana	20.6	5.1	Yes	No	Transport, Storage, and Communications
5.	Khazanah	20.0	5.0	Yes	No	Finance
6.	Maybank	14.9	3.7	No	Yes	Banking
7.	Pengurusan Air	13.8	3.4	Yes	No	Energy, Gas, and Water
8.	Perbadanan Tabung Pendidikan Tinggi Nasional	11.0	2.7	Yes	No	Finance
9.	CIMB Bank	10.1	2.5	No	No	Banking
10.	Sarawak Energy	9.5	2.4	Yes	No	Energy, Gas, and Water
11.	Jimah East Power	9.0	2.2	Yes	No	Energy, Gas, and Water
12.	Public Bank	8.6	2.1	No	No	Banking
13.	Aman Sukuk	6.3	1.6	Yes	No	Construction
14.	Rantau Abang Capital	6.0	1.5	Yes	No	Finance
15.	RHB Bank	5.4	1.3	No	No	Banking
16.	Turus Pesawat	5.3	1.3	Yes	No	Transport, Storage, and Communications
17.	CIMB Group Holdings	5.2	1.3	Yes	No	Finance
18.	BGSM Management	5.1	1.3	No	No	Transport, Storage, and Communications
19.	1Malaysia Development	5.0	1.2	Yes	No	Finance
20.	Danga Capital	5.0	1.2	Yes	No	Finance
21.	Putrajaya Holdings	4.9	1.2	Yes	No	Property and Real Estate
22.	Manjung Island Energy	4.9	1.2	No	No	Energy, Gas, and Water
23.	YTL Power International	4.8	1.2	No	Yes	Energy, Gas, and Water
24.	Celcom Networks	4.5	1.1	No	No	Transport, Storage, and Communications
25.	Malakoff Power	4.4	1.1	No	No	Energy, Gas, and Water
26.	Bank Pembangunan Malaysia	4.4	1.1	Yes	No	Banking
27.	GOVCO Holdings	4.3	1.1	Yes	No	Finance
28.	AM Bank	4.2	1.0	No	Yes	Banking
29.	Cagamas MBS	4.2	1.0	Yes	No	Finance
30.	Tanjung Bin Power	4.0	1.0	No	No	Energy, Gas, and Water
31.	Telekom Malaysia	4.0	1.0	Yes	Yes	Transport, Storage, and Communications
32.	Valuecap	4.0	1.0	Yes	No	Finance
<b>Total Top 32 LCY Corporate Issuers</b>		<b>295.3</b>	<b>73.3</b>			
<b>Total LCY Corporate Bonds</b>		<b>519.4</b>	<b>128.9</b>			
<b>Top 32 as % of Total LCY Corporate Bonds</b>		<b>56.8%</b>	<b>56.8%</b>			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.

Notes:

1. Data as of end-June 2016.

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.

**Table 3 : Notable Local Currency Corporate Bond Issuance in Q2 2016**

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
Sarawak Energy		
15-year Islamic MTN	5.04	800
20-year Islamic MTN	5.18	700
Pengurusan Air		
5-year Islamic MTN	4.04	400
7-year Islamic MTN	4.23	800
10-year Islamic MTN	4.40	250
GOVCO Holdings Berhad		
7-year Islamic MTN	4.27	300
10-year Islamic MTN	4.40	400
15-year Islamic MTN	4.73	550
CIMB Bank		
Perpetual Capital Securities - Tier 1	5.80	1,000

MTN = medium-term note, MYR = Malaysian ringgit, Q2 = second quarter.  
Source: Bank Negara Malaysia Bond Info Hub.

## Investor Profile

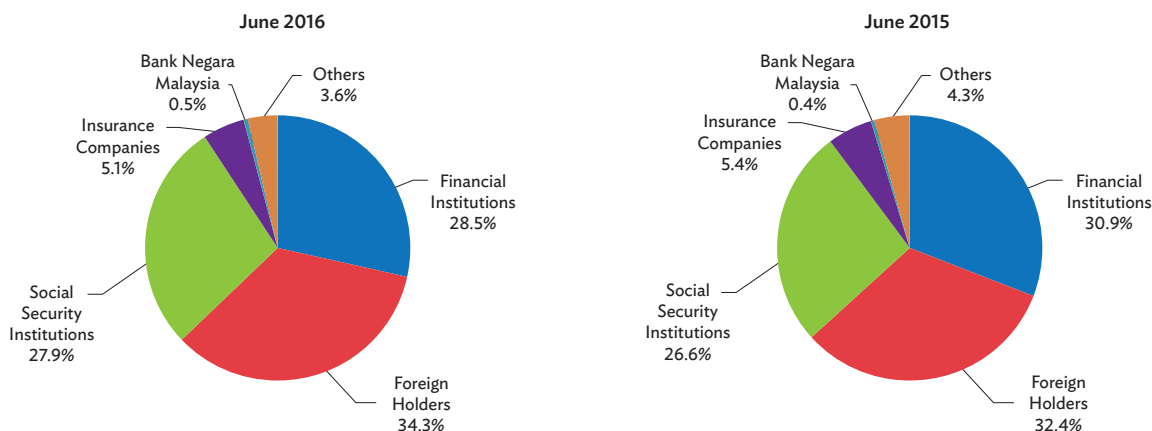
Foreign investors' holdings of LCY government bonds were up in June from a year earlier, both in nominal terms and as a share of the total. In a change from a year earlier, foreign holdings accounted for the largest investor

share at the end of June at 34.3%, surpassing financial institutions' share of 28.5%. Social security institutions remained the third largest holders of government bonds at the end of June with a share of 27.9%, down from 26.6% a year earlier.

Malaysia's corporate bond market investor profile was barely changed in June compared with a year earlier (**Figure 3**). Domestic banks, both commercial and Islamic, continued to account for the largest share of LCY corporate bonds at 46.5%, followed by life insurance companies with a share of 31.5%.

## Ratings Update

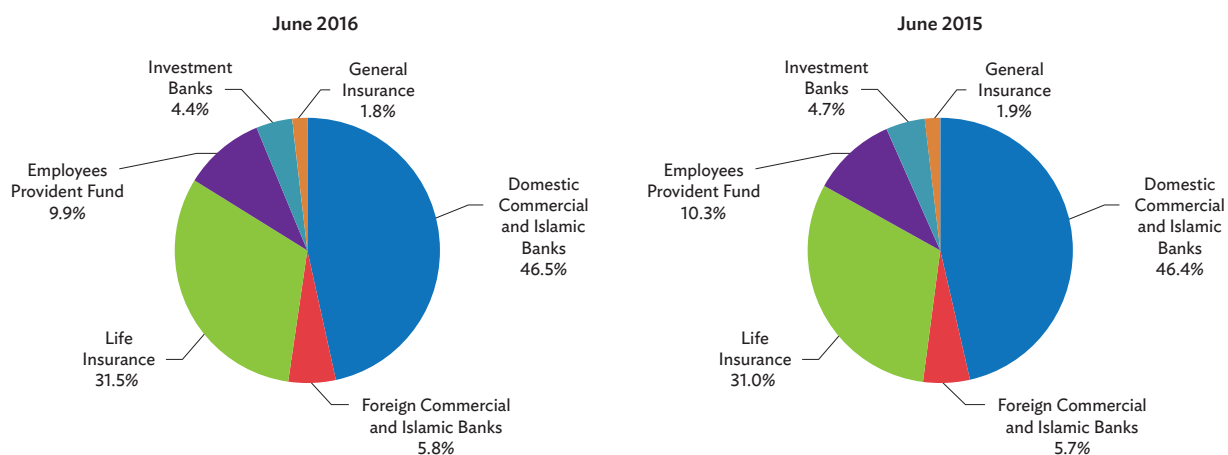
In August, Fitch Ratings (Fitch) affirmed its long-term foreign currency and local currency issuer default ratings of A- for Malaysia, with a stable outlook. Fitch cited as reasons for its decision Malaysia's strong net external creditor position and current account surplus, and strong (despite slower) economic growth relative to its A- rated peers. However, Fitch also noted weakness in Malaysia's governance standards, citing ongoing issues with state-owned 1Malaysia Development Berhad as well as concerns over its federal government debt and deficit levels.

**Figure 2: Local Currency Government Bonds Investor Profile**

**Notes:**

- "Others" include statutory bodies, nominees and trustee companies, and cooperatives and unclassified items.
  - Data are based on the Bank Negara Malaysia Monthly Statistical Bulletin Table 3.1.5: Federal Government Debt Issued Domestically, Classification by Holder.
- Source: Bank Negara Malaysia.

Figure 3: Local Currency Corporate Bonds Investor Profile



Note: The Employees Provident Fund's bond holdings data are as of end-December 2015 since data are based on EPF's annual report.  
Source: Bank Negara Malaysia and the EPF.

## Policy, Institutional, and Regulatory Developments

### Bank Negara Malaysia and Financial Markets Association of Malaysia Announce Kuala Lumpur USD–MYR Reference Rate

In June, BNM and the Financial Markets Association of Malaysia announced the adoption of a new methodology for the computation of the Malaysian ringgit's exchange rate. The new rate shall be known as the Kuala Lumpur USD–MYR Reference Rate. Effective 18 July, the new reference rate will be based on the daily weighted average volume of the interbank USD–MYR foreign exchange spot rate transactions of domestic financial institutions between 8 a.m. and 3 p.m. BNM stated that the new methodology promotes transparency and is based on underlying trades, while the previous methodology was based on the submission of quotations by selected banks.

In addition, the official closing time for the onshore ringgit foreign exchange market will be extended from 5 p.m. to 6 p.m.

### Bank Negara Malaysia and Otoritas Jasa Keuangan Sign Bilateral Agreement

In August, BNM and Otoritas Jasa Keuangan signed a bilateral agreement under the Association of Southeast Asian Nations Banking Integration Framework to further promote banking and financial integration between Malaysia and Indonesia. The implementation of the agreement will involve BNM allowing Qualified Association of Southeast Asian Nations Banks from Indonesia to operate in Malaysia. The agreement envisions a greater role for Malaysian and Indonesian banks in facilitating cross-border trade and investment between the two markets.