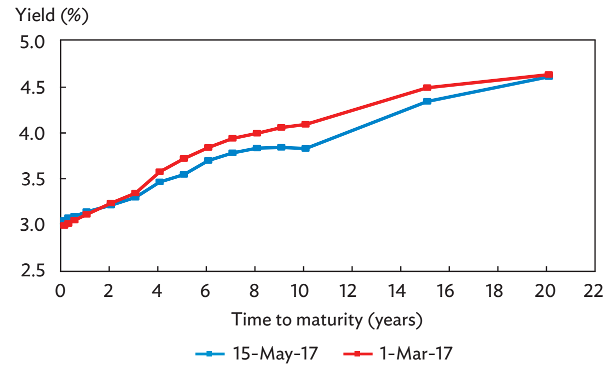
Malaysia

Yield Movements

Between 1 March and 15 May, local currency (LCY) government bond yields in Malaysia fell for most tenors, specifically those securities with tenors of between 2 years and 20 years (**Figure 1**). The largest drop in yields was seen in the 10-year tenor, which declined 26 basis points (bps), while a smaller drop was seen in the 2-year and 20-year tenors of 2 bps each. The decline in yields reflected restored confidence in the domestic bond market as foreign funds returned due to government policy initiatives to develop the local bond market, coupled with the recovery of the Malaysia ringgit and improved prospects for the economy. In contrast, bond yields at the short-end of the yield curve increased. On average, the yields for 3-month to 1-year tenors advanced 5 bps. The increase in short-end yields to some extent reflected lingering risk associated with the sell-off by foreign investors of LCY government bonds concentrated on shorter tenors. According to Bank Negara Malaysia (BNM), the bulk of the reduction in foreign holdings was in maturities of less than 1 year.[25] The yield spread between 2-year and 10-year government bonds declined by 24 bps during the review period.

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



Source: Based on data from Bloomberg LP.

BNM decided to maintain the overnight policy rate at 3.0% during its meeting on 12 May. The central bank's stance remained supportive of the markets' economic conditions and growth prospects, and inflation remained within BNM's expectations. While inflation has been trending higher, it mainly reflected the pass-through impacts of higher global oil prices and temporary supply disruptions that fed into higher consumer prices. Inflation is expected to moderate in the second half of the year. Malaysia' growth momentum from the latter part of 2016 is expected to carry into the first quarter (Q1) of 2017 and be sustained for rest of the year. On the external front, improving global economic conditions will support Malaysia's economic performance, particularly from exports. BNM has maintained its overnight policy rate since a 0.25-percentage points reduction in July 2016.

Malaysia's inflation rate moderated to 4.4% year-on-year (y-o-y) in April after sharply increasing to 5.1% y-o-y in March. The March number is the highest since posting an inflation rate of 5.7% y-o-y in November 2008. Both March and April consumer price inflation was driven by increasing fuel prices in the transport sector. Average inflation in January–April 2017 was 4.3%, higher than the 3.1% inflation rate posted in the same period in 2016. Core inflation, which excludes volatile items, remained stable at 2.5% y-o-y in April.

The ringgit appreciated 3.7% against the United States (US) dollar year-to-date through 15 May. The ringgit has recently recovered from its lows in November and December 2016, supported by BNM's currency measures, an improved inflow of foreign funds, and resilient economic fundamentals.

Malaysia's economy expanded faster than expected at 5.6% y-o-y in Q1 2017, overtaking the fourth quarter (Q4) of 2016 growth of 4.5% y-o-y. The Q1 2017 gross domestic product (GDP) growth was also the fastest in 2 years since 5.8% y-o-y growth was posted in Q1 2015. Malaysia's economy was lifted by strong private consumption expenditure and investment, as well as a robust recovery in exports. BNM stated that domestic demand is projected to continue to expand, supporting the economy, while exports are expected to benefit from the improvement in global growth. The central bank

[25] Bank Negara Malaysia. Statement by Financial Markets Committee: Roundtable Discussion on Bond Market Development. 14 March 2017. http://www.bnm.gov.my/index.php?ch=en_press&pg=en_press&ac=4392&lang=en

forecast Malaysia's GDP growth at between 4.3%–4.8% for full-year 2017. Meanwhile, Malaysia had laudable GDP growth of 4.2% y-o-y in 2016, led by strong private consumption expenditure and investment. In 2015, GDP growth was 5.0% y-o-y.

Size and Composition

Total LCY bonds outstanding in Malaysia expanded 3.3% quarter-on-quarter (q-o-q) and 5.7% y-o-y, reaching MYR1,206 billion (USD272 billion) at the end of March (**Table 1**). The q-o-q growth was a turnaround from the 0.1% q-o-q backslide seen in Q4 2016. On a y-o-y basis, the growth was faster. Despite the foreign outflow pressure and risks stemming from the global front, growth remained positive in the LCY bond market, reflecting that the market has large support from local investors. The Islamic capital market maintained its dominant position from the high issuance of *sukuk* (Islamic bonds) at end of March with a share of 57.1% of total LCY bonds outstanding.

Issuance of LCY bonds sharply rebounded in Q1 2017. Total issuance during the quarter summed to MYR76.9 billion on increases of 54.4% q-o-q and 24.1% y-o-y, reversing the double-digit drop seen in Q4 2016. The pace of issuance can be traced to market lenders locking in lower rates before a highly anticipated rate hike by the US Federal Reserve in March. The recovery of the ringgit may have also helped renew investor interest in Malaysia's bond market.

Government Bonds. LCY government bond outstanding stood at MYR651 billion at the end of March, rising 2.7% q-o-q and 3.5% y-o-y. The increase was propelled by central government bonds, which made up 94.2% of the total government bond stock. Central government bonds grew 2.7% q-o-q and 5.9% y-o-y.

Government bonds propelled growth in the LCY bond market in Q1. Issuance doubled on a quarterly basis and rose by 36.3% over the previous 12 months. Bond sales from the government totaled MYR38.9 billion during the quarter, comprising Malaysian Government Securities (MGS) and Government Investment Issues. Issuance of MGS had a dramatic increase to MYR15 billion in Q1 2017 from MYR4 billion in Q4 2016. Treasury bills and central bank bills issuance also showed positive q-o-q growth in Q1 2017. The strong bond issuance reflected the Malaysian government's increased financing needs in 2017.

Foreign holdings of LCY government bonds at the end of March dropped 18.3% to MYR156.7 billion from MYR191.8 billion at the end of December 2016 (**Figure 2**).[26] Foreign investors began to offload

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

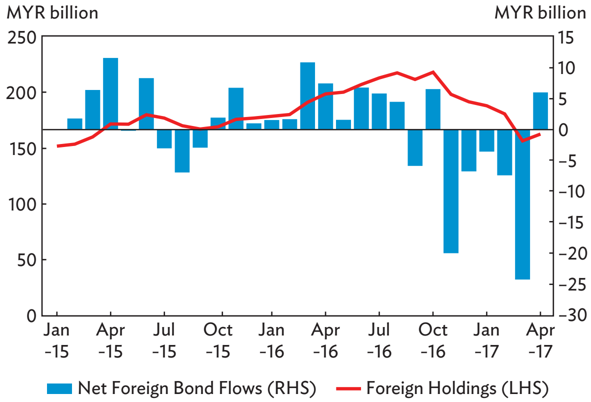
	Outstanding Amount (billion)						Growth Rate (%)			
	Q1 2016		Q4 2016		Q1 2017		Q1 2016		Q1 2017	
	MYR	USD	MYR	USD	MYR	USD	q-o-q	y-o-y	q-o-q	y-o-y
Total	**1,141**	**293**	**1,167**	**260**	**1,206**	**272**	**1.9**	**6.3**	**3.3**	**5.7**
Government	628	161	634	141	651	147	2.7	2.7	2.7	3.5
Central Government Bonds	579	148	596	133	613	138	3.5	9.0	2.7	5.9
of which: *Sukuk*	223	57	236	53	252	57	3.3	14.3	6.6	12.9
Central Bank Bills	22	6	9	2	10	2	(12.2)	(62.3)	9.7	(55.3)
of which: *Sukuk*	0	0	0	0	0	0	(100.0)	(100.0)	–	–
Sukuk Perumahan Kerajaan	28	7	28	6	28	6	0.0	16.4	0.0	0.0
Corporate	512	131	534	119	555	125	1.0	11.1	4.0	8.3
of which: *Sukuk*	366	94	395	88	409	92	1.4	11.5	3.6	11.7

( ) = negative, – = not available, MYR = Malaysian ringgit, q-o-q = quarter-on-quarter, Q1 = first quarter, Q4 = fourth 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.

[26] Foreign holdings of debt securities and *sukuk*, excluding Bank Negara Malaysia bills.

Figure 2: Foreign Holdings of Local Currency Government Bonds



LHS = left-hand side, MYR = Malaysian ringgit, RHS = right-hand side.
Notes:
1. Figures exclude foreign holdings of Bank Negara Malaysia bills.
2. Month-on-month changes in foreign holdings of local currency government bonds were used as a proxy for bond flows.
Source: Bank Negara Malaysia Monthly Statistical Bulletin.

their holdings of LCY government bonds when the unexpected outcome of the US presidential election led to speculation that was exacerbated by BNM's clamping down on nondeliverable forwards in order to stabilize the ringgit. This drew a significant amount of net foreign capital out of Malaysia's bond market in Q4 2016 and Q1 2017. During Q1 2017, Malaysia posted MYR35 billion net foreign outflows. Foreign holdings of MGS, which accounted for about 87.0% of total government securities held by foreign investors, declined 19.3% from the end of December to the end of March with net foreign outflows reaching MYR32.6 billion. By April, foreign fund flows turned positive with MYR6.0 billion monthly net foreign inflows, resulting in a total of MYR162.8 billion in foreign holdings of government bonds. Recent efforts by Malaysian policy makers to liberalize the bond market and the improving performance of the ringgit helped renew investor confidence in sovereign securities.

Corporate Bonds. Total LCY corporate bonds outstanding amounted to MYR555 billion at the end of March, an increase of 4.0% q-o-q and 8.3% y-o-y. With a large amount of issuance and a relatively low level of bond redemptions in Q1 2017, the corporate bond market managed to reverse the 0.5% q-o-q decline and even outpace the 5.2% y-o-y growth posted in Q4 2016.

Bonds outstanding from the top 30 corporate issuers at the end of March comprised 55.4% of the total LCY corporate bond market, which reached an aggregate amount of MYR307.7 billion (**Table 2**). The majority of the companies in the top 30 are not listed on Malaysia's stock exchange and 20 of them are state-owned. Companies from the finance industry dominated the list with a combined outstanding amount of MYR144.9 billion, while property and real estate accounted for only MYR5.1 billion. The government's funding vehicle for infrastructure projects, Danainfra Nasional, had the most outstanding bonds with MYR32.4 billion at the end of March, followed by privately owned transport, storage, and communications company, Project Lebuhraya Usahasama, with MYR30.4 billion.

Corporate bond market issuance rebounded in Q1 2017, with issuance amounting to MYR38.1 billion compared with MYR30.3 billion in the preceding quarter and MYR33.5 billion in Q1 2016. The increase in issuance was underpinned by government guaranteed bonds for Malaysia's key infrastructure projects. By instrument type, medium-term notes remained the dominant instrument in the corporate sector with a total issuance of MYR23.9 billion in Q1 2017.

Notable issuances in Q1 2017 are listed in **Table 3**. SapuraKencana TMC issued MYR3,366 million in a multitranche sale of 7-year maturities.

Investor Profile

The investor profile of government bond holders was little changed at the end of December 2016 from the previous year (**Figure 3**). Foreign investors continued to account for the largest share of LCY government bond holdings with a share that rose slightly to 32.2% from 31.5% in December 2015 despite foreign capital outflows toward the end of the year. Social security institutions followed with a 28.3% share, just overtaking financial institutions with a 28.0% share. Shares of insurance companies and other holders both decreased in 2016. BNM's holdings of LCY government bonds increased but remained the lowest overall at 1.0%.

For LCY corporate bonds, the investor profile generally remained unchanged between March 2016 and March 2017, with domestic commercial and Islamic banks accounting for the highest ownership share at 38.9% at the end of the review period (**Figure 4**). Marginal increases in the share of holdings were seen in life insurance companies and foreign commercial and Islamic

Table 2: Top 30 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.	Danainfra Nasional	32.4	7.3	Yes	No	Finance
2.	Project Lebuhraya Usahasama	30.4	6.9	No	No	Transport, Storage, and Communications
3.	Cagamas	27.5	6.2	Yes	No	Finance
4.	Prasarana	18.7	4.2	Yes	No	Transport, Storage, and Communications
5.	Khazanah	18.0	4.1	Yes	No	Finance
6.	Perbadanan Tabung Pendidikan Tinggi Nasional	16.7	3.8	Yes	No	Finance
7.	Maybank	14.7	3.3	No	Yes	Banking
8.	Pengurusan Air	14.0	3.2	Yes	No	Energy, Gas, and Water
9.	Sarawak Energy	9.5	2.1	Yes	No	Energy, Gas, and Water
10.	CIMB Bank	9.5	2.1	No	No	Finance
11.	Jimah East Power	9.0	2.0	Yes	No	Energy, Gas, and Water
12.	GOVCO Holdings	7.6	1.7	Yes	No	Finance
13.	Bank Pembangunan Malaysia	7.4	1.7	Yes	No	Banking
14.	Public Bank	7.4	1.7	No	No	Banking
15.	Rantau Abang Capital	7.0	1.6	Yes	No	Finance
16.	Sarawak Hidro	6.5	1.5	Yes	No	Energy, Gas, and Water
17.	Aman Sukuk	6.1	1.4	Yes	No	Construction
18.	ValueCap	6.0	1.4	Yes	No	Finance
19.	CIMB Group Holdings	5.4	1.2	Yes	No	Finance
20.	Turus Pesawat	5.3	1.2	Yes	No	Transport, Storage, and Communications
21.	RHB Bank	5.2	1.2	No	No	Banking
22.	Putrajaya Holdings	5.1	1.2	Yes	No	Property and Real Estate
23.	1Malaysia Development	5.0	1.1	Yes	No	Finance
24.	Celcom Networks	5.0	1.1	No	No	Transport, Storage, and Communications
25.	Danga Capital	5.0	1.1	Yes	No	Finance
26.	GENM Capital	5.0	1.1	No	No	Finance
27.	YTL Power International	4.8	1.1	No	Yes	Energy, Gas, and Water
28.	AmBank	4.7	1.1	No	No	Banking
29.	Jambatan Kedua	4.6	1.0	Yes	No	Transport, Storage, and Communications
30.	Manjung Island Energy	4.5	1.0	No	No	Energy, Gas, and Water
Total Top 30 LCY Corporate Issuers		**307.7**	**69.5**			
Total LCY Corporate Bonds		**555.1**	**125.4**			
Top 30 as % of Total LCY Corporate Bonds		**55.4%**	**55.4%**			

LCY = local currency, MYR = Malaysian ringgit, USD = United States dollar.
Notes:
1. Data as of end-March 2017.
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 the First Quarter of 2017

Corporate Issuers	Coupon Rate (%)	Issued Amount (MYR million)
SapuraKencana TMC		
7-year bond	6.37	1,413
7-year bond	6.53	1,102
7-year bond	6.48	426
7-year bond	6.46	350
7-year bond	4.85	75
GOVCO Holdings		
15-year bond	4.95	1,250
10-year bond	4.55	500
7-year bond	4.29	625
5-year bond	4.10	625
Cagamas		
5-year bond	4.15	2,000

MYR = Malaysian ringgit.
Source: Bank Negara Malaysia Bond Info Hub.

banks, while marginal decrease were seen in investment banks and the Employees Provident Fund. General insurance companies' holdings were unchanged at 2.3%.

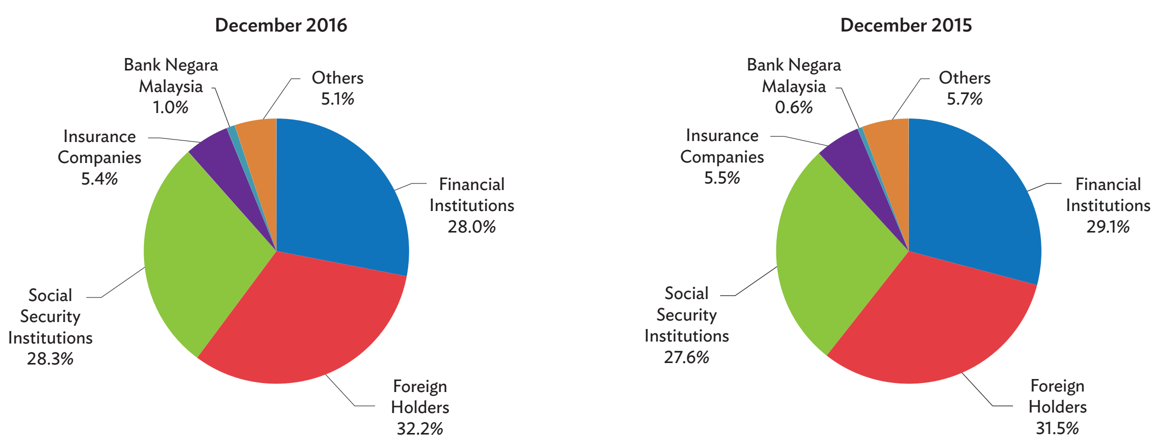
Ratings Update

In January, RAM Ratings affirmed Malaysia's global sovereign rating at $_{g}A_{2}$ and its ASEAN-scale sovereign rating at $_{sea}$AAA with a stable outlook, reflecting the market's economic resilience despite domestic and external risks. The Government of Malaysia's fiscal consolidation efforts and the market's sustained current account surplus supported the rating. However, RAM Ratings stated that if there is deterioration in the fiscal position as a result of rising debt, a persistent current account deficit, or significant deviations in the country's economic or fiscal conditions, Malaysia's rating could be revised downward.

Fitch affirmed Malaysia's long-term foreign currency and local currency international default rating at A– in April with a stable outlook based on a promising economic environment and growth prospects. Despite offloading from foreign investors in Q4 2016, which put downward pressure on the ringgit and international reserves, Malaysia managed to maintain a strong net external creditor position, resilient GDP growth, and a current account surplus. The ratings firm flagged the Malaysian government's fiscal consolidation efforts to narrow the deficit as a positive development while failure to implement these efforts, which would lead to a deterioration of fiscal discipline, were flagged as risks.

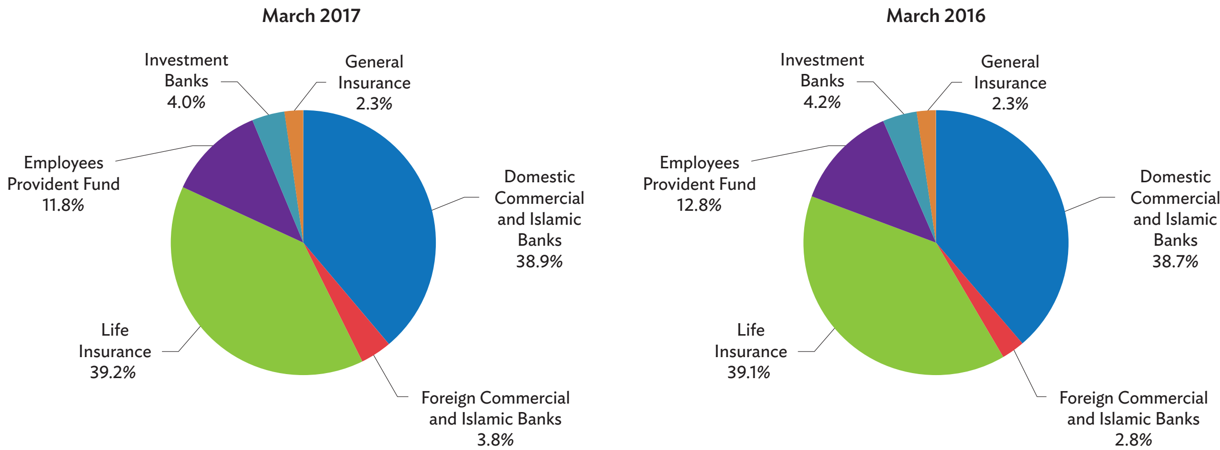
Malaysian Rating Corporation Berhad affirmed Malaysia's sovereign rating of AAA with a stable outlook in April. The rating was supported by the market's sound macroeconomic fundamentals, which were underpinned by resilient economic growth, a sustainable and strong external position, a strong and well-supervised banking system, and effective governance. The credit watcher flagged fiscal performance and high government and household debt levels as rating constraints.

Figure 3: Local Currency Government Bonds Investor Profile



Note: "Others" include statutory bodies, nominees and trustee companies, and cooperatives and unclassified items.
Source: Bank Negara Malaysia.

Figure 4: Local Currency Corporate Bonds Investor Profile



Note: The Employees Provident Fund's bond holdings data are as of end-December 2016.
Sources: Bank Negara Malaysia and the Employees Provident Fund.

Policy, Institutional, and Regulatory Developments

Securities Commission Allows Regulated Short-Selling of Corporate Bonds

In April, Malaysia's Securities Commission allowed principal dealers, primarily banks, to undertake a regulated short-selling of corporate bonds. The Securities Commission has set out conditions on how the regulated short-selling of corporate bonds is to be conducted and the requirements to ensure market stability. The commission's regulatory development is in line with Malaysia's efforts to develop its bond market and boost liquidity.

Bank Negara Malaysia Eases Rules on Short-Selling of Government Securities

BNM eased rules on the short-selling of MGS effective 2 May. The move is part of the liberalization measures by the central bank to develop domestic financial markets and restore investor interest in government debt. Prior to this development, only licensed banks and investment banks were allowed to short-sell MGS. The new rule allows companies and insurers to short-sell MGS to help them manage their risk and generate more trading volume, resulting in higher liquidity onshore. The central bank also said this will attract foreign investors to bring funds back to the domestic market. The clampdown on nondeliverable forwards launched in November in an effort to stabilize the ringgit saw foreign investors offload government securities.

The Bank of Japan and Bank Negara Malaysia Conclude Bilateral Currency Swap Agreement

The Bank of Japan and BNM reached a bilateral currency swap agreement in early May. The agreement between the central banks will allow them to swap their currencies with US dollars when needed up to a maximum of USD3 billion. The arrangement will deepen the economic and trade ties between the Japanese and Malaysian markets and contribute to financial stability in Southeast Asia.